The Federal Government in a Federal System: Current Intergovernmental Programs and Options for Change

A CBO Study
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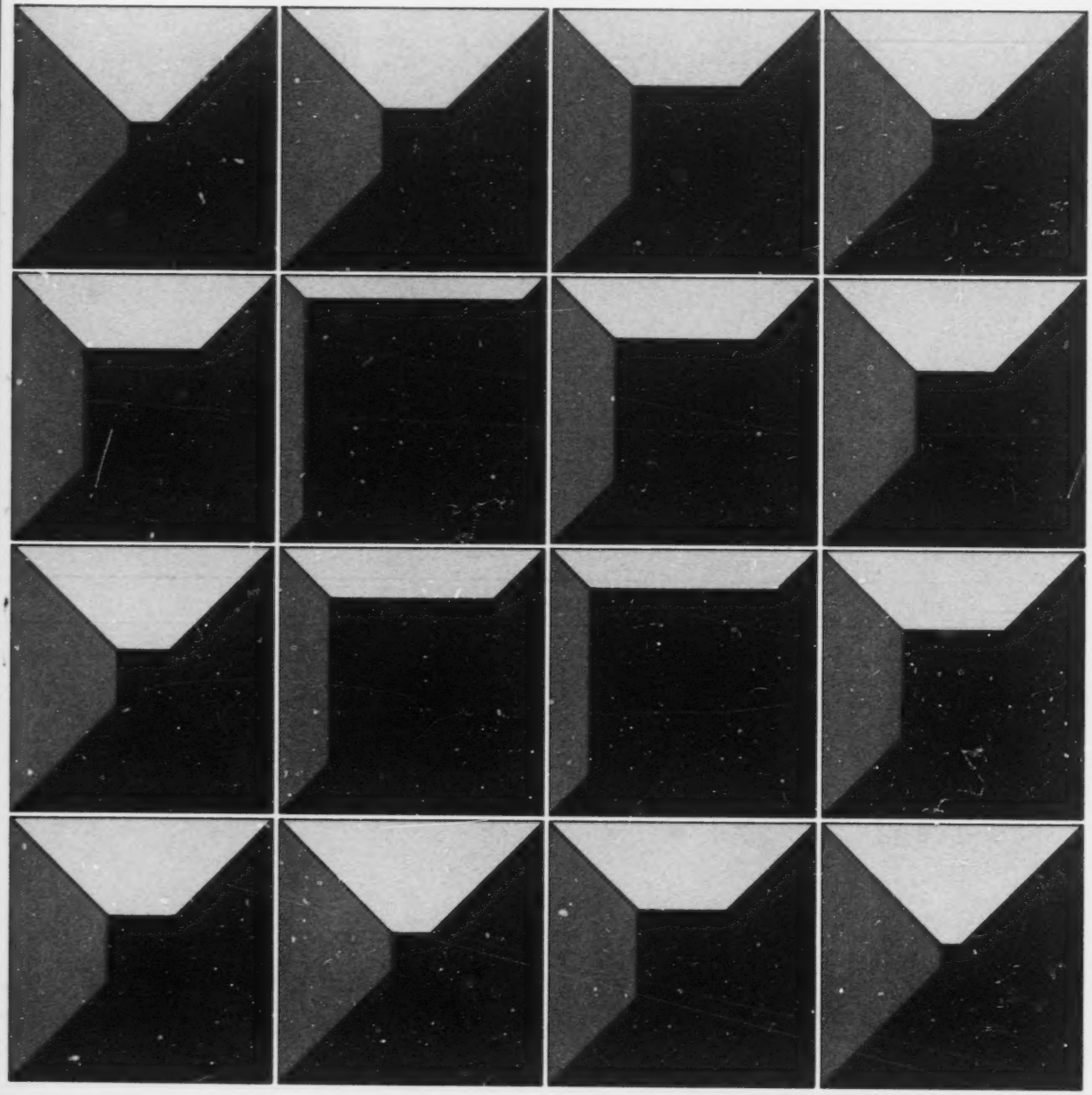

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THE FEDERAL GOVERNMENT IN A FEDERAL SYSTEM: CURRENT INTERGOVERNMENTAL PROGRAMS AND OPTIONS FOR CHANGE

The Congress of the United States
Congressional Budget Office

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All years are fiscal years unless otherwise indicated. Budget data for 1983 include all appropriations authorized up to August 15, 1983. In particular, they include supplemental appropriations under Public Law 98-8 and Public Law 98-63.

PREFACE

As federal involvement in the activities of state and local governments has grown, so has criticism of the intergovernmental system. Problems have developed, in part, because there are no generally accepted criteria to define and limit the federal role. This study, undertaken at the request of the Subcommittee on Intergovernmental Relations of the Senate Committee on Governmental Affairs, develops guidelines that could be used to identify activities for which some federal role is important, and applies them to current intergovernmental programs. In keeping with CBO's mandate to provide objective analysis, the study offers no recommendations.

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Alice M. Rivlin
Director

August 1983

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SUMMARY

The federal government currently funds almost 300 different programs that provide grants to state and local governments. These grants cover a wide variety of government activities, and will cost nearly $100 billion in 1983--more than 10 percent of the total federal budget. In spite of this myriad of federal programs and the large federal financial commitment, no clear set of principles is used to determine the need for federal participation, nor are there any generally accepted rules for deciding the form that federal participation should take. As a result, the current grants system is often perceived as disorganized and wasteful. In addition, if the federal government intervenes in areas where there is no clear national purpose, it may inappropriately limit state and local choices, leading to a misallocation of resources and to unnecessary administrative costs.

In an attempt to deal with these perceived problems, in 1982 the Administration proposed a massive realignment of responsibilities between the federal government and the states. Under this proposal, the federal government would have turned over to the states primary responsibility for current programs in areas such as cash public assistance, education, social services, and transportation, while assuming greater responsibility for some health services for the poor. In order to help states fund their expanded responsibilities, some federal tax bases would have been relinquished to them. In large part, the rationale for this proposal was that state and local governments are generally closer to the groups served, and therefore would be able to design and run more efficient and responsive programs. The proposal met with opposition, however, both from members of Congress who felt that such a major realignment would leave important national interests unmet, and from state and local governments that doubted their ability, even with the additional revenue sources, to pay for the new responsibilities proposed for them.

Although the Administration's proposal was not enacted, it did help to focus attention on the need for some reorganization of the intergovernmental structure. Under the federal system, states and localities are primarily responsible for the provision of local public services--police protection, for example. The primary role of the federal government is to coordinate activities between states and to provide services with more-than-local benefits, such as national defense. In general, federal participation is necessary only if there is an important national purpose that would not be served without federal involvement. Identification of such

areas can be difficult and controversial, however. The aim of this paper is to propose some guidelines to aid in this identification, and then to apply them to options for modifying federal responsibilities in four major areas of the budget. 1/

HISTORY AND CURRENT STATUS OF THE GRANTS SYSTEM

Federal grants to states and localities grew very rapidly in the 1960s and 1970s, largely in response to changing perceptions of the appropriateness of government intervention in solving a wide variety of social and environmental problems. Funding through the intergovernmental grants system developed because, although states and localities had the administrative structure needed to address these problems, they often lacked the ability or the willingness to finance programs in these areas.

By the start of 1981 there were four times as many grant programs as there had been in 1960, and real spending levels--that is, spending adjusted for inflation--had increased more than four times (see Summary Table). The scope of areas in which grants were funded had also increased considerably--in 1960, the bulk of federal grant money went to programs for income security and transportation, while by 1981 there were also large programs for education, training, social services, health care, environmental management, and general government. In percentage terms, the largest growth was in health care programs (principally Medicaid) and energy spending; the health care area now has the second highest funding level overall, after income security.

In recent years, however, attention has turned from developing new programs toward improving existing ones. In part, this new focus has been a response to the haphazard growth of the previous years--a desire to step back and evaluate the results of that growth. It was also, in part, a response to economic and fiscal conditions that pressed the Congress to reduce federal spending in general. As a result, spending for grants has declined in real terms since 1978, and in 1982 outlays fell below the 1981 level in nominal terms. The number of grants has also dropped--from more than 400 in 1980 to under 300 in 1982--through consolidation into block grants in some areas and elimination of funding in others.

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1. Most programs discussed in this paper are grants, but some non-grant programs have also been included because they provide services similar to those available through grants or because they have other intergovernmental ramifications.

SUMMARY TABLE. GROWTH IN FEDERAL OUTLAYS FOR GRANTS, BY FUNCTION (In billions of current dollars)

Program Areas	Outlays 1960	Outlays 1970	Outlays 1980	Percentage Growth in Real Terms 1960-1980	1982 Outlays	Percentage Change in Real Terms 1980-1982 a/
Infrastructure and Development						
Energy	6	25	499	2,420	509	-7
National Resources and Environment	108	429	5,362	1,404	4,871	-17
Transportation	2,999	4,538	13,087	32	12,171	-15
Community and Regional Development	109	1,780	6,486	1,703	5,379	-24
Education, Training, and Social Services	526	6,390	21,862	1,101	16,589	-36
Income Security and Health						
Income Security	2,635	5,819	18,495	186	21,930	+2
Health	214	3,850	15,758	1,819	18,839	-3
General Purpose Fiscal Assistance	159	430	8,478	1,441	6,347	-37
Other a/	264	753	1,445	58	1,559	-9
Total Outlays for Grants	7,020	24,014	91,472	334	88,194	-17

SOURCE: Office of Management and Budget for outlays. Specialized deflators for each spending category were used.

a. Includes grants for national defense, agriculture, commerce, veterans' programs, administration of justice, and general government.

In a period of budget cutbacks, the effective use of federal funds--including the elimination of unnecessary or duplicative efforts--becomes especially important. Although the committee structure of the Congress makes it difficult to coordinate program changes in different areas, a consistent set of guiding principles to determine the need for federal involvement in each area could help to develop a better-organized grants system in the coming years.

REASSESSING THE FEDERAL ROLE

There are two basic questions to consider in evaluating federal involvement in particular state or local activities. First, is federal involvement necessary? Second, if it is, what form should that involvement take? These can be difficult and controversial questions, and there are few programs for which the answers are clear. Nevertheless, the aim of this paper is to set out some criteria to use as guidelines.

Before deciding if the federal government should intervene, it is necessary to decide if a response is needed from any level of government. Three major concerns that may justify government intervention are:

- Spillovers or external effects--that is, costs or benefits from particular activities that cross jurisdictional borders;
- Benefits from centralized coordination--efficiency or other gains from centralized planning and coordination of services; and
- Poor distribution of resources--that is, inequities or hardships that are unusually severe for certain groups or regions in the country.

Once a need for some governmental role has been established, the justification for federal--rather than state or local--involvement depends on the extent to which the problem is non-local in nature; that is, the extent to which there are important national interests that would not be met without federal involvement. The existence of interstate spillovers, the need for administrative coordination between states, or the desire for redistribution among states, for example, would all constitute such national interests.

If federal involvement seems to be necessary, the form this involvement should take also depends to some extent on the reason for federal intervention. If the rationale for federal participation stems from the existence of spillovers, for example, federal subsidies designed to curtail

activities with external costs or to expand activities with external benefits are appropriate. Where the basis for federal activity is the need for centralized administration, direct federal provision may be most effective. When the federal interest involves the distribution of resources, direct federal provision or a narrowly focused categorical program would be necessary if the major consideration was the supply of particular public goods or services or the welfare of particular recipients within jurisdictions, while more broadly defined grants programs or general revenue sharing may be appropriate if the concern is instead the general level of resources available to states and localities for providing large classes of public services.

This paper applies these criteria for government involvement to programs in three major sectors of the budget: infrastructure and development; education, employment, and social services; and income security and health. In each of these areas, the current program structure is analyzed, and options for realignment are examined. In addition, a final chapter discusses general revenue sharing and the relinquishing of federal tax bases.

OPTIONS FOR MODIFYING GRANTS PROGRAMS

Some broad categories of options for modifying the federal role in current programs can be identified. The major approaches examined in this study are:

- Eliminating federal funding;
- Changing funding provisions; and
- Changing program rules.

Eliminating Federal Funding

Eliminating federal funding might be appropriate for programs where there is not now a strong interjurisdictional basis for involvement--that is, where there are no interstate spillovers, efficiency gains, or distributional issues. In some cases, there may originally have been such a basis, which has now become outdated or unnecessary as circumstances have changed. In others, the basis for federal involvement may have been limited from the start.

An example of an area where the elimination of federal funding might be appropriate is the support provided for roads of predominantly local importance under Federal-Aid Highway programs. Such roads include

Secondary System (rural) and Urban System routes--roads that are probably not essential to a national, interconnected system of highways. Elimination of federal funding for them, on the other hand, would impose additional financial burdens on state governments, although these could be offset, if desired, by reducing the federal tax on motor fuels (which would allow higher state taxes) or by allocating part of the revenues from the federal fuel tax to the states.

Elimination of funding might also be appropriate in a number of other grant programs. Examples include operating subsidies for mass transit, general education grants, and some child nutrition programs. The advantages and drawbacks of eliminating these programs are discussed in the relevant chapters of this study.

Changing Funding Provisions

Changes in the funding provisions for federal grants could take several different forms. For example, in some programs it might be appropriate to change from a project-based allocation of funds to a formula-based approach. In others, an alteration in the allocation formula might improve the effectiveness of a program. Finally, in some cases it might be beneficial to alter the cost-sharing arrangements between recipient governments and the federal government. Such changes could help to redistribute federal resources toward groups with greater needs, take better account of spillover costs or benefits, or increase administrative efficiency.

Changing from project funding to formula funding in the bilingual education program might be desirable, for example, in order to compensate localities facing higher education costs as a result of federal immigration policy and civil rights laws, which require schools to provide special language services for non-English-speaking students. Currently, less than 20 percent of students requiring services are in federally funded programs. A formula-based federal program could distribute funds to all school districts based on the number of non-English-speaking students and the average additional costs of serving such children. This option would increase federal spending, however, and would change the current program's purpose from capacity-building to continuing support.

General revenue sharing is an example of a program where changing the allocation formulas might be appropriate. The formulas for allocating funds to local governments, both among and within states, are based on population, tax effort, and per capita income. Per capita income is included to measure fiscal capacity but does so poorly, because income is only one of several important components of state and local tax bases. In addition,

because severance taxes are included in the tax effort calculation, substantial GRS payments are allocated to local governments in energy-rich states. The interstate allocation would be better targeted if tax effort was eliminated from the formula altogether and a more comprehensive measure of fiscal capacity was used, such as the Representative Tax System (RTS) compiled by the Advisory Commission on Intergovernmental Relations. 2/ On the other hand, the data required for updating the RTS depend in part on nongovernment sources, so that new government data series might have to be developed to implement this option.

An area where changing the cost-sharing ratio might be desirable is capital grants for transit programs. The high federal share under current law means that in most urban areas the availability of federal funds strongly influences local transit priorities and encourages capital-intensive solutions to transit problems. While the federal share of costs for these programs will be reduced in 1984 from 80 to 75 percent, a further reduction to 60 percent would double the local share from what it has been, thereby encouraging localities to commit funds only to projects they really need and to focus on the most cost-effective ways of moving people. On the other hand, such a reduction could increase financial burdens for state and local governments, and might cause particular hardship for some urban areas with limited resources.

Changes in funding provisions might also be appropriate in a number of other areas, such as highway aid, vocational education, some social service programs, and some income security programs such as Aid to Families with Dependent Children (AFDC). These and other examples are discussed at greater length in the body of this study.

Changing Program Rules

Changes in program rules could be implemented in two major ways. They could be designed either to consolidate diverse and possibly overlapping programs in a given area, or to change the degree of discretion allowed to recipient governments in using funds. Where there is no overriding national interest that calls for close federal control over the allocation of program funds, greater state and local discretion can increase program efficiency without jeopardizing federal goals.

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2. Changes might also be beneficial in the intrastate allocation of GRS payments. These are discussed in Chapter VII.

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Consolidating Existing Programs. A great deal of program consolidation has already taken place within the last two years. In the area of health care, for example, more than 20 different programs were combined into four block grants under the Omnibus Budget Reconciliation Act of 1981. The addition of three smaller health care programs--family planning, migrant health services, and black lung clinics--to the Primary Care Block Grant has been proposed by the Administration but has not been enacted by the Congress. Combining these categorical programs with the existing block grant might reduce administrative costs somewhat and would give local agencies--in many cases, the same agencies that already receive funds under the Primary Care Block Grant--greater flexibility. On the other hand, if agencies used their increased discretion to reduce the funds available for the specific purposes of the existing categorical programs, significant spillover benefits might be lost--for example, the prevention of unwanted births to teenage mothers, which tend to increase federal welfare costs.

Consolidation might be beneficial in a number of other areas, such as vocational education, some social services, and child nutrition. In addition, some analysts have argued that a comprehensive restructuring and consolidation of the federal public assistance system could lead to both greater efficiency and better targeting of federal resources.

Making Federal Regulations More Flexible. Relaxing federal regulations could be beneficial in a number of areas, including wastewater treatment, mass transit, and highways. In most cases these changes would logically complement the withdrawal or reduction of federal funds by giving state and local governments more freedom in how they use their funds. For example, if federal highway dollars for local roads were withdrawn, state governments could be freed to apply their own road standards based on local traffic characteristics. In the area of wastewater treatment, current regulations embodied in the Clean Water Act could be interpreted more flexibly in cases where there is little economic justification for requiring the upgrading of wastewater treatment facilities. One example is coastal systems in which natural currents are sufficient to prevent environmental degradation from wastewater discharge. To handle such situations, site-specific coastal waivers might be issued to allow less intensive treatment of wastewater where warranted by local conditions.

CHAPTER I. INTRODUCTION

The federal government shares with states and localities the responsibility for carrying out a wide range of public activities, primarily through grants-in-aid. In 1983, the Congress will channel about $100 billion to nonfederal governments through nearly 300 grant programs. These federal grants touch virtually every state and local activity, including programs that provide cash or in-kind benefits for individuals (such as Aid to Families with Dependent Children and Medicaid) and programs that finance government services (such as education and road construction).

The extent of federal involvement in state and local affairs increased substantially over the last two decades, in response to expanding perceptions of the proper role of government and concerns about the capacity of nonfederal governments to meet perceived needs. At the beginning of 1981, the number of grant programs was four times what it had been in 1960, and grants spending (in constant dollars) was more than four times the 1960 level. 1/ During this time federal involvement also expanded greatly in scope; in 1960 it supported primarily income security and transportation programs, but by 1981 it included subsidies for environmental quality, education, training, social services, health care, and general government services as well.

As the ways in which the federal government interacts with state and local governments increased in number and complexity, so did public dissatisfaction with the intergovernmental system. Criticism of the system is now widespread, including complaints that it contributes to waste through programs that are ineffective, outdated, duplicative, and unnecessarily inflexible. The criticism gathers force from the fact that, in some instances, the rationale for federal involvement in any form is unclear, while in others the form of federal involvement seems poorly designed to address federal goals.

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1. According to estimates by the Advisory Commission on Intergovernmental Relations (ACIR), 539 grant programs were authorized in 1981. The Office of Management and Budget, which uses a different method of counting separate programs, estimates that 360 intergovernmental grants were funded in 1981. See ACIR, Significant Features of Fiscal Federalism, 1981-82 Edition, p. 66.

The Administration sparked renewed interest in identifying the considerations underlying federal involvement by its 1982 proposal for a massive realignment of responsibilities in current programs. If this proposal had been enacted, the federal government would have assumed greater responsibility for some health services for the poor, but lesser responsibility in a number of other areas including cash assistance, education, social services, and transportation. The proposal was not enacted, however, because of disagreements about what role the federal government should play in these areas.

THE PROBLEM--HOW TO DEFINE AN APPROPRIATE FEDERAL ROLE

A major factor behind the development of the current wide-ranging grants system is the lack of generally accepted guidelines to identify activities for which some federal role is important. Without such guidelines, virtually any social problem left unattended by some state or local governments may lead to federal involvement, unless constrained by budgetary concerns.

The problems of determining whether federal involvement is appropriate in a given program area, and if so what form it should take, are perennial. The Congress makes such a determination, implicitly if not explicitly, each time it authorizes a new program or modifies or eliminates an existing program. The current grants system is the result of numerous decisions of this sort made piecemeal by various committees of the Congress as individual programs were considered. The fragmented nature of this legislative process makes it difficult to eliminate poor coordination and duplication among programs entirely, but the grants system might be considerably improved if guidelines for federal involvement were developed and used by the Congress.

PLAN OF THE STUDY

This study suggests guidelines the Congress could use to isolate areas in which federal involvement is appropriate and to determine the form it should take. In later chapters, it applies these guidelines to specific programs.

The guidelines are developed in Chapter II as a framework for analysis. Following Chapter III, which gives an overview of the current grants system, the remainder of the study examines specific program areas more thoroughly. Infrastructure and development programs are analyzed in

Chapter IV. Chapter V covers education, employment, and social service programs. Chapter VI discusses income security and health programs, with an emphasis on public assistance. Finally, revenue-sharing and other means by which the resources of state and local governments might be increased for general purposes are considered in Chapter VII.

CHAPTER II. FRAMEWORK FOR ANALYSIS

This chapter presents some general principles that could be used to determine where there is an appropriate federal role and what might better be left to nonfederal governments or to the private sector. It also describes the forms of federal involvement now in use, some problems with them, and general approaches for modifying current programs. This framework is the basis for analysis of specific programs in later chapters.

REASONS FOR FEDERAL INVOLVEMENT

Concerns that might justify involvement by some level of government are described first in this section, followed by discussion of the considerations that could help to determine whether federal involvement was required or whether state or local government involvement would be sufficient.

A strong governmental role is most clearly justified by concern with one or more of the following:

- Spillovers or external effects--costs or benefits from particular activities that cross jurisdictional borders;
- The advantages of centralized coordination--efficiency or other gains from centralized planning to insure coordinated services; and
- Poor distribution of resources--inequities or hardships that are unusually severe for certain groups or regions.

The relative importance of these concerns varies among programs. Spillovers and administrative efficiency are the dominant considerations underlying infrastructure programs, for example, while modifying the distribution of resources is the dominant concern in public assistance programs.

Spillovers or External Effects

Some activities generate costs or benefits that spill over to other communities. As an example, improper wastewater disposal may have little

effect on the community creating the problem, but impose substantial costs on downriver communities because of the health, aesthetic, or cleanup costs they must bear. The residents of the community causing the pollution may lack the incentive to build sufficient wastewater treatment capacity unless they receive a subsidy to cover the costs of the necessary equipment, or are subject to pollution penalties more costly than the equipment. In general, government intervention--through penalties or subsidies that reflect the value of external effects--can result in the curtailment of activities with spillover costs and the expansion of activities with spillover benefits.

Centralized Coordination

Government intervention is also appropriate when it makes possible substantial efficiency or other gains from centralized control or administration. The Social Security system provides an example of gains from federal administration, because it permits a uniform retirement plan based on detailed records of individual contributions over a working lifetime that may include employment with a number of employers in different states. Development of the Interstate Highway System is another example, in which federal coordination ensured that routes planned and standards used within each state were consistent nationwide.

Distribution of Resources

The desire to relieve hardship or inequity has fostered numerous government programs--at both the federal and state levels--intended to redistribute resources among people or communities. The largest federal redistributive programs provide benefits for individuals, either cash assistance as in the Aid to Families with Dependent Children (AFDC) program, or in-kind assistance as in health care and nutrition programs. Other redistributive programs increase public services available to disadvantaged groups, such as compensatory education for the poor and special education for handicapped children. Finally, community development programs and revenue-sharing redistribute resources among political jurisdictions, in order to promote economic development or to assure some basic level of public services.

Additional Considerations

In many instances the scope of the problem is limited enough so that intervention by state, or even local, governments would be sufficient if they were willing to undertake it. If the scope of the problem crosses state

boundaries, however, federal (or multi-state regional) intervention may be necessary. For example, spillover effects from municipal wastewater pollution may not be limited to downriver communities within a state, but may affect communities in neighboring states as well. Similarly, benefits from centralized coordination may be limited to a metropolitan region in the case of ground transportation, but be nationwide for national defense and the air traffic control system. Redistribution of resources among states requires federal intervention, although redistribution among regions within a state need not.

In some instances more than one consideration may be involved, and these sometimes conflict. Regulations to reduce spillover costs--pollution from industrial production in a depressed region, for example--might impose hardship on people in the region by raising production costs and thereby reducing employment and income. Or benefits from programs to deal with spillover effects might be swamped by their administrative costs, especially if the external effects are limited.

FORMS OF FEDERAL INVOLVEMENT

Federal involvement can take a number of forms. In many instances, the federal government pursues its goals directly, with program funding, policy control, and administration independent of nonfederal governments--as in the air traffic control system and Social Security. In other areas, responsibilities are shared through grants-in-aid. In grant programs, administrative responsibilities are delegated to nonfederal governments, and some responsibility for funding and policy control may be delegated as well. 1/

Policy Choices in Shared Programs

Program responsibilities are shared in a variety of ways, as the result of choices made about:

- How to allocate federal funds;
- Whether and how to require cost sharing by grant recipients; and

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1. The Supplemental Security Income program is one exception to the delegation of administration for intergovernmental programs. In this program, administration may be either state or federal, whether or not the federal minimum standard is supplemented by the state.

- How much policy control to delegate to grant recipients--that is, how restrictive to make federal program rules.

Allocation of funds. Most programs providing benefits for individuals are entitlements--where the program rules determine eligibility for benefits, but spending is a consequence of the number of eligible individuals who apply. Federal funds for the major entitlements that are grants--AFDC and Medicaid--are allocated among the states in accordance with state spending under the programs. In nonentitlement programs--where the Congress sets spending totals--funds may be allocated to selected applicants on a project basis, or they may be allocated among states or localities according to formulas that assure some payment to all qualifying areas. These formulas generally include some measure of program need--such as road miles for highway programs, and population for social service programs--and they may include a measure of fiscal capacity as well. 2/

The method by which program funds are allocated has implications for the way program benefits are distributed among the population. For entitlements, all individuals who satisfy the program's eligibility conditions and who apply receive benefits. The federal government can control spending for entitlements only by altering the program rules. For non-entitlements, by contrast, the federal government controls spending by appropriation limits, but total spending is often inadequate to provide services to all who may qualify. When non-entitlement grants are allocated by project, the federal government plays a large part in determining how services will be distributed among all those who qualify for them, but it has no such discretion when non-entitlement grants are allocated by formula.

Cost Sharing. In current entitlement programs, cost sharing--if any--takes one of two forms. The federal government may pay 100 percent of a minimum benefit standard, as in the Supplemental Security Income (SSI) program, permitting states to provide supplemental benefits entirely at their own expense. Alternatively, as in the AFDC and Medicaid programs, the federal government may reimburse states for some share of total benefits paid. Cost-sharing provisions, if any, in non-entitlement programs generally require that recipients match federal grant dollars in some specified proportion as a condition of receiving the grant.

Cost sharing is typically justified on one of the following bases. For one, it is used to increase service levels when there are sufficient local benefits that nonfederal governments would undertake the activity without

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2. The fiscal capacity of a government is its ability to raise revenues of its own. It depends primarily on the value of the tax bases the government may assess.

federal funding, but at a level the Congress would consider inadequate because, for example, of spillover benefits. Cost sharing is also used to increase incentives for recipients to use program dollars efficiently, since they may be less tolerant of waste when their own dollars are involved. Finally, cost-sharing rates may be based on a concern with the unequal distribution of resources--the rates varying inversely with the fiscal capacity of the recipient so as to reduce differences in the tax effort that nonfederal governments must make to fund their share of program costs.

Policy Control. The extent of policy control delegated to grant recipients, by definition, varies inversely with the restrictiveness of federal program rules. In entitlement programs, eligibility and benefit levels may be determined entirely by the federal government--as in the Food Stamp program--or jointly by federal and recipient governments--as in the AFDC and Medicaid programs. 3/ Non-entitlements may specify a narrow set of allowable uses for federal funds--as in bilingual education--or may support a variety of services within a broad functional area--as with the Social Services Block Grant. Revenue sharing is a grant for which allowable local discretion is virtually unrestricted.

Very restrictive program rules are appropriate when the Congress wants to control exactly how grant funds are used, whether or not this would conflict with local interests. When, however, the Congressional interest is in encouraging more activity in a broad functional area, or in targeting more services on certain population groups, greater allowance for local interests and differences--through more flexible rules--might be made without jeopardizing federal goals. A portion of grants that support services already provided by recipient governments will likely be used to replace nonfederal funding rather than to further expand services, however, unless maintenance of effort requirements are imposed.

SOME PROBLEMS CITED IN CURRENT PROGRAMS

The need for federal involvement is in some cases unclear, while in others its form may be inappropriate. In either instance, programs might be modified to achieve a more effective use of federal dollars.

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3. In the AFDC program, categorical requirements for eligibility are determined by the federal government, but benefit levels--and hence income limits for eligibility--are set entirely at the states' discretion. In the Medicaid program, the federal government sets minimum requirements for groups covered and services provided, but states may cover certain additional groups and provide certain additional services, with the federal government sharing the additional costs.

Federal dollars may be poorly used in some water resource programs--for example, those that were originally intended to hasten the development of the West--because development has been largely completed. Federal support may not be necessary for some other programs because their benefits are primarily local, without significant spillovers. Critics cite federal grant programs for secondary highways and for rural roads as examples, as well as federal subsidies for general education programs.

In other areas, changes in the form of federal involvement might result in programs that could better address current concerns. For example, cost-sharing provisions are frequently criticized, for a variety of reasons. Critics suggest that the structure of matching rates in Interstate Highway programs might be altered to favor repair and maintenance over new construction, since the sections of the Interstate System that remain unbuilt are predominantly of local importance, while deterioration of the existing national network is of growing concern. Cost-sharing provisions for most education and social service grants that subsidize traditional state and local activities serve little purpose at present, although they may increase administrative costs, because the federal grants are so small relative to spending by recipient governments that the matching requirements are irrelevant. Finally, cost-sharing provisions in the AFDC program--requiring federal reimbursement to states for a portion of the benefits they pay--direct as much or more federal aid per capita to high-income states as to other states that the Congress might prefer to favor. 4/

Other criticisms of current federal programs concern the way in which federal funds are allocated, the desirability of certain program rules, and the benefits of multiple programs that provide similar services. For example, federal programs that subsidize education and social services might more effectively address concerns for spillovers and hardship if federal funds were targeted more toward disadvantaged groups or poor jurisdictions. Even programs that are allocated by a formula that includes a measure of fiscal capacity might be more effectively targeted, since the measure of fiscal capacity typically used--per capita income--is not suffi-

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4. This occurs despite the use of matching rates that vary inversely with a state's per capita income. It is due, in part, to the minimum value set in current legislation that restricts variation in matching rates to a narrow range (between 50 and 78 percent). In addition, it reflects the fact that rich states tend to have more generous public assistance programs than poor states. See Albert Davis and Robert Lucke, "The Rich-State Poor-State Problem in a Federal System," National Tax Journal, vol. 35, no. 3 (September 1982), p. 351.

ciently comprehensive to serve this purpose well. 5/ In addition, some programs that are intended to induce localities to provide special services for disadvantaged groups may be too inflexible, while others may allow too much discretion to local agencies to accomplish the purposes the Congress intended. Finally, consolidation of related programs in some areas--such as infrastructure or social services--might benefit recipient governments by reducing administrative costs and increasing flexibility, while still adequately addressing problems of concern to the Congress.

WAYS TO MODIFY CURRENT PROGRAMS

Specific options for modifying current federal programs discussed in later chapters are of three general types. The federal government could eliminate (or assume) program responsibility, change funding provisions, or change program rules.

Eliminate or Assume Program Responsibility

Under this approach, the program would no longer be intergovernmental. Either it would be left to nonfederal governments to continue at their own expense, if they chose to do so; or it would be a federal program with federal funding, policy control, and administration. In either case, activities might be managed more effectively because a single government would be held fully accountable. Complete elimination of federal responsibility would be inappropriate for programs that address significant federal concerns about spillovers, administrative efficiency, or the distribution of resources, however, while assumption of full federal responsibility for such programs might be undesirable if the services provided depended on local conditions.

Change Funding Provisions

This approach could include altering the process by which federal funds are allocated among recipient governments, changing the cost-sharing provisions, or both. The allocation process could be used to target federal funds more effectively by, for example, modifying the measures of program need or fiscal capacity used in the distribution formulas for some programs.

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5. A more comprehensive alternative often suggested is the fiscal capacity measure currently compiled by the Advisory Commission on Intergovernmental Relations, based on the Representative Tax System. See Chapter VII for further discussion of this measure.

Changing cost-sharing provisions by altering matching rates might mean that the federal share of costs would better reflect the extent of spillovers from program activities. Another way of changing cost-sharing provisions--relevant to some public assistance entitlements, for example--would be to fund a minimum federal benefit, rather than to reimburse states for part of total benefits they set. This approach might better ensure that federal aid for public assistance was distributed according to need, and could make public assistance benefits more uniform nationwide. Implementing it could increase federal costs substantially, however, depending on how high a minimum was chosen.

Change Program Rules

This approach could entail redefining the population to be served, changing the activities allowed or the benefits provided, or modifying administrative requirements. Recipient governments might be given either more or less discretion over the groups served and the kind of services provided with program funds. Relaxation of requirements or consolidation of related programs--ways in which more discretion could be allowed--might be appropriate in areas where federal restrictions distort local priorities but not in any way clearly related to federal goals. In other areas, where recipient governments seem not to be serving the groups the Congress wished to aid or to be using program funds for broader purposes than the Congress intended, requirements might more appropriately be strengthened.

CHAPTER III. THE CURRENT INTERGOVERNMENTAL STRUCTURE

The size of the public sector relative to the economy has increased substantially over the last 50 years. In 1929, just before the Depression, spending by all levels of government was 10 percent of GNP, with spending by state and local governments about three times as large as federal expenditures (see Figure 1). By 1939, total government spending had almost doubled--to 19 percent of GNP--and the federal share had grown to equal the nonfederal share. Although government spending grew to nearly 50 percent of GNP during the war years, by 1950 it was not much larger relative to GNP than it had been in 1939. Between 1950 and 1982, spending by all levels of government increased from 21 percent to 35 percent of GNP. Direct spending by the federal government grew from 13 percent to 22 percent of GNP, and federal grants-in-aid to other governments rose from less than 1 percent to 3 percent of GNP. Spending by states and localities from their own sources rose from 7 percent of GNP in 1950 to 11.5 percent in 1975, before dropping to 10.5 percent in 1982.

In calendar year 1982, combined spending by governments at all levels in the United States was $1.1 trillion--35 percent of the gross national product (GNP). 1/ Federal expenditures accounted for nearly $800 billion (or 25 percent of GNP), including nearly $700 billion spent directly by the federal government and about $85 billion in grants channeled to nonfederal governments. States and localities spent more than $300 billion from their own sources (or about 10 percent of GNP) to finance public services. 2/

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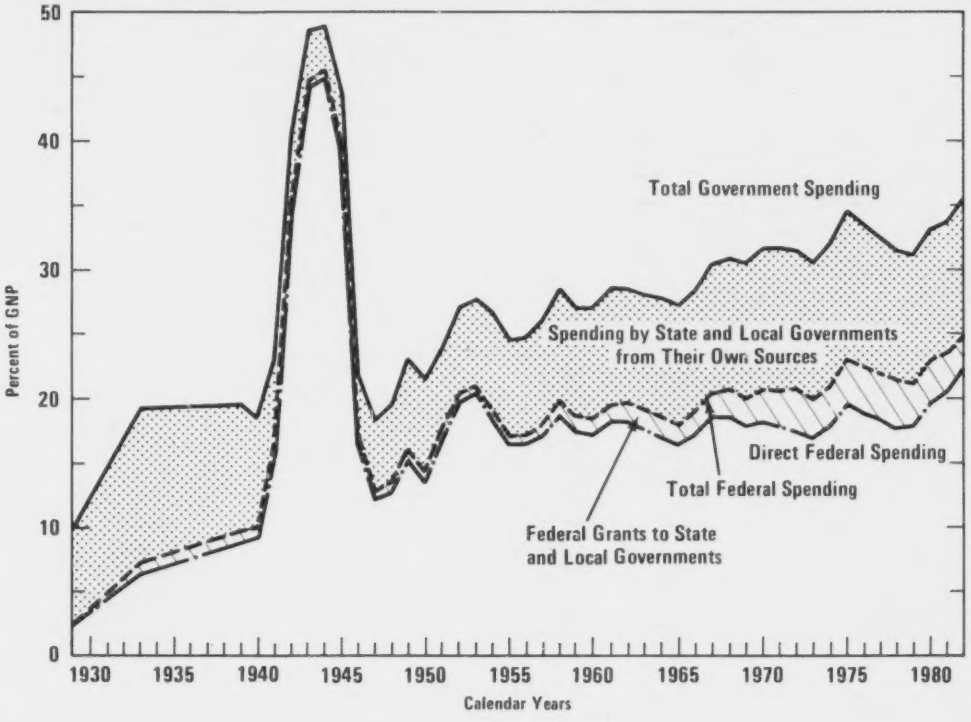
1. This rate is among the lowest among western industrialized nations. As of 1980, total government expenditures in the United States amounted to about one-third of the gross domestic product (GDP)--a concept that measures production within the borders of a country. As of the same year, total government expenditures as a percent of GDP were half a percentage point less in Japan and one percentage point more in Australia. In ten other industrialized nations, however, the public sector was far larger, ranging from 41 percent of GDP in Canada to nearly two-thirds of GDP in Sweden. See Organization for Economic Cooperation and Development, Economic Outlook, vol. 31 (July 1982), p. 149.

2. Economic Report of the President, 1983, Appendix B. All figures for spending by different levels of government are for calendar years on a National Income and Product Accounts basis, and thus differ somewhat from those reported in most federal budget documents.

Figure 1.

Government Spending as a Percent of Gross National Product, 1929-1982



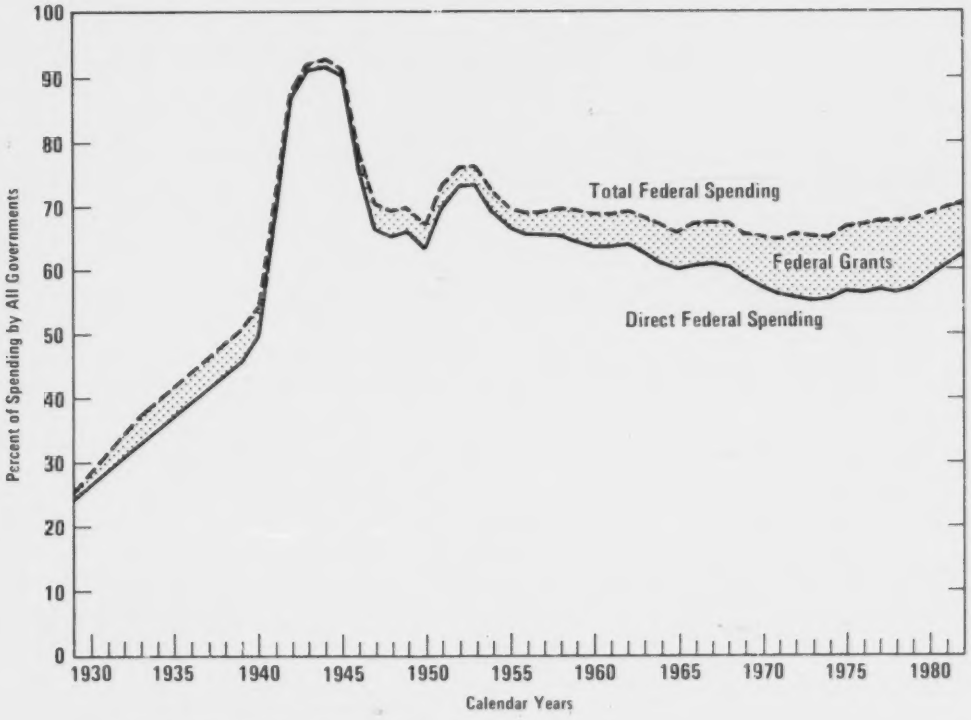
SOURCE: *Economic Report of the President* (1983).

The Growth of Intergovernmental Grants

While the federal share of all government spending has remained fairly constant since 1950--between 65 and 70 percent, except for the Korean War period--an increasing proportion of federal spending has been through intergovernmental grants (see Figure 2). In 1950, federal grants to nonfederal governments were about 6 percent of all federal spending; by 1978, intergovernmental grants had risen to 17 percent of all federal spending, before declining to 11 percent in 1982.

Figure 2.

Total Federal Spending and Direct Federal Spending as a Percent of Spending by All Governments, 1929-1982



SOURCE: *Economic Report of the President* (1983).

As a result of the rapid growth in federal grants, coupled with the slower rise in spending by states and localities from their own sources, nonfederal governments rely much more on the federal government for financial support than previously. Federal grants as a percent of all state and local expenditures rose from 10 percent in 1950 to a peak of 26 percent in 1978, before dropping to 21 percent in 1982 (see Figure 3). It is estimated that 25 percent of federal aid goes directly to local governments, and that another 20 percent goes to local governments indirectly after passing through state governments first. 3/ To some extent, the growth in grants

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3. See Advisory Commission on Intergovernmental Relations, Recent Trends in Federal and State Aid to Local Governments (July 1980), Table 5, p. 8.

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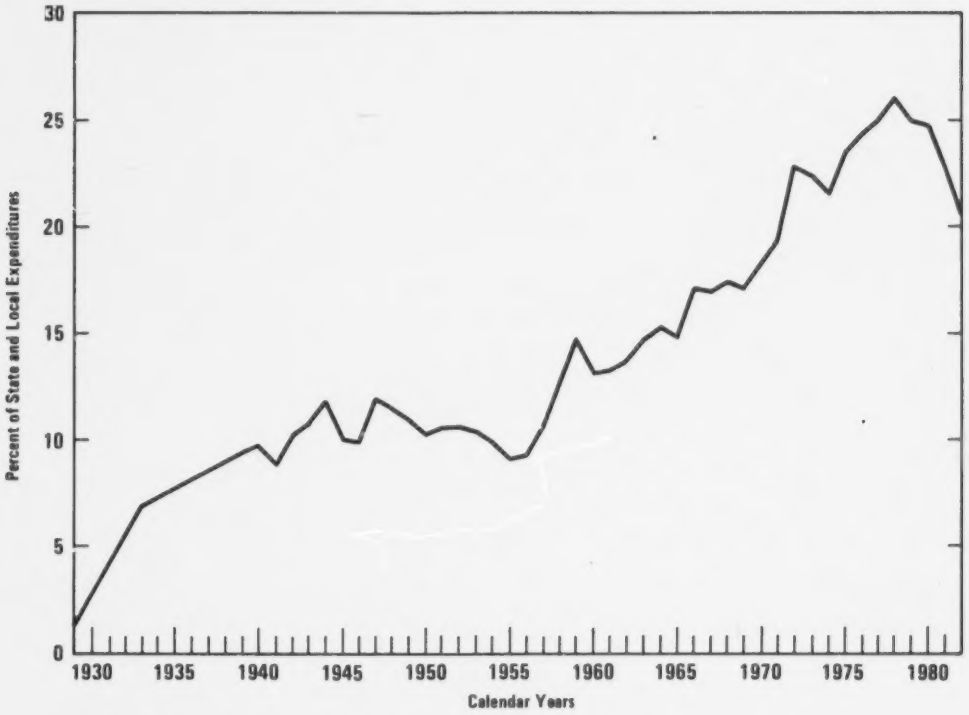
Figure 3.

Federal Grants as a Percent of State and Local Expenditures, 1929-1982



SOURCE: *Economic Report of the President* (1983).

has allowed the federal government to use nonfederal governments as administrative agents. This is reflected in government employment figures, which show that state and local government employment grew by 218 percent from 1950 to 1982, while federal employment grew by only 42 percent. 4/

The Broadening Scope of Federal Aid

Along with the growth in grants has come a broadening in the scope of state and local activities supported by the federal government. In 1950, 80

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4. Economic Report of the President, 1983, Table B-37, p. 205.

percent of federal grants were in two areas--income security (principally AFDC), which accounted for 59 percent of grants; and transportation, which accounted for 21 percent of grants (see Table 1). In 1960, these two areas still accounted for more than 80 percent of all grants, but the proportion of grants going for transportation had more than doubled--to 43 percent--as a result of the Interstate Highway program begun during the 1950s, and the proportion for income security had shrunk to 38 percent. The introduction of new grant programs in community development, education, employment, social services, and health during the 1960s, however, reduced the share of income security and transportation programs to 43 percent of all grants by 1970, and to only 34 percent by 1980. 5/

The remainder of this chapter provides an overview of the present grants system and traces its evolution from the Depression years to the present.

THE PRESENT GRANTS SYSTEM

In fiscal year 1982, the federal government gave $88.2 billion to states and localities through 280 grant programs. About 46 percent of these outlays provided benefits for individuals, almost entirely through income security and health programs. 6/ The remaining outlays supported state or local public services. It is estimated that 27 percent of spending for all grants was for infrastructure programs (energy, natural resources, and transportation) or for economic development; 19 percent was for education, employment, and social service programs; and 7 percent was for general purpose fiscal assistance.

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5. Part of the decline in the share of grants going to transportation was due to the near completion of the Interstate Highway System. Transportation grants are expected to increase for 1983 and later years due to the increase in the federal motor fuels tax which is to be used for major repairs on the Interstate System and for mass transit.

6. In 1982, more than 99 percent of grant outlays providing benefit payments for individuals were for income security and health, and more than 99 percent of grant outlays for income security and health programs provided benefit payments for individuals. There is substantial non-grant spending both for income security and health and for programs providing benefits for individuals.

TABLE 1. PERCENTAGE DISTRIBUTION OF FEDERAL GRANT-IN-AID OUTLAYS BY FUNCTION, SELECTED YEARS

Budget Function	1940	1950	1960	1970	1980	1981	1982
Energy	*	*	*	*	1	1	1
Natural Resources and Environment	*	1	2	2	6	5	6
Agriculture	3	5	3	4	1	1	1
Transportation	19	21	43	19	14	14	14
Community and Regional Development	32	*	2	5	7	6	6
Education, Training, Employment, and Social Services	3	7	7	27	24	22	19
Health	2	5	3	16	17	20	21
Income Security	39	59	38	24	20	23	25
General Purpose Fiscal Assistance	1	2	2	2	9	7	7
Other	*	*	*	1	1	1	1
Total	100	100	100	100	100	100	100

SOURCE: Office of Management and Budget.

* = 0.5 or less.

Grants for Infrastructure and Development

In 1982, $22.9 billion in grants to states and localities were to provide for transportation needs, to protect the environment, and to promote community and regional development. The largest transportation program is the Federal-Aid Highway program, which supports construction and major repairs on the Interstate Highway System and on non-Interstate intercity routes. This aid is provided principally through grants allocated by formula and funded by federal motor fuels taxes. In addition, the federal government provides both project and formula grants for capital and operating assistance for mass transit. The principal environmental grant program provides project grants for the construction of wastewater treatment

facilities. The Community Development Block Grant (CDBG) program is the largest program for development assistance. Under this program, most funds are provided to large cities and urban counties on a formula basis to be spent on community improvements such as housing rehabilitation, streets and roads, waterworks, and other public facilities.

Grants for Education, Employment, and Social Services

Spending for these human service grant programs was $16.6 billion in 1982, providing support for elementary, secondary, and vocational education; for employment and training; and for social services. Within each of these program areas, a few large formula-distributed grants accounted for the bulk of all spending, with three programs alone accounting for about 40 percent in 1982. 7/ More than 100 narrower-purpose grants--many distributed on a project basis--together accounted for the other 60 percent of human service grants spending.

Some of these programs are intended to expand the overall level of services that states and localities might be expected to provide in any event. Others are intended to fund services that states and localities might not otherwise provide or to assure that some specific target group receives a higher level of services than would otherwise be available. Although more than half of these human service grants require that recipient governments contribute from their own funds as a condition of receiving federal assistance, no state-local contribution is required under the three largest programs. When a state or local contribution is required, it is typically quite low--generally 10 to 25 percent of total spending under the grant--although in some instances it is as large as 67 percent.

Grants for Income Security and Health

In 1982, the federal government spent $40.8 billion in state and local grants to finance income security and health programs, almost all of which provided benefits for individuals. The largest of these individual assistance grant programs are AFDC and Medicaid--state-administered entitlement programs that are jointly financed by the federal government and the states.

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7. The three programs were for grants to local educational agencies under Chapter I of the Education Consolidation and Improvement Act (ECIA), Title II B-C programs under the Comprehensive Employment and Training Act (CETA), and the Social Services Block Grant under Title XX of the Social Security Act.

In both instances, the federal government sets certain categorical criteria for eligibility, while the states determine the income limits for eligibility. The federal government contributes a little more than half of all program costs, on average, although the federal share varies by the state's per capita income from a floor of 50 percent to 78 percent.

Other grants fund child nutrition programs; various specialized health care programs, such as the maternal and child health block grant and community health centers; housing assistance; and cash and in-kind energy assistance for low-income households. Some of the child nutrition programs are entitlements, but most of these programs are non-entitlement formula grants.

General-purpose Grants

The federal government distributed $6.3 billion to states and localities in 1982 in the form of general-purpose fiscal assistance--funding that jurisdictions could use for virtually any purpose. The largest of these programs--General Revenue Sharing--distributed $4.6 billion to more than 39,000 general purpose local governments on the basis of each jurisdiction's population, per capita income, and tax effort. Other general-purpose fiscal assistance grants included the distribution of revenues collected by the Forest Service and the Bureau of Land Management, and federal payments in lieu of taxes to the District of Columbia and other federally affected communities.

THE EVOLUTION OF THE GRANTS SYSTEM

The present system of intergovernmental grants reflects Congressional decisions made over many years in response to changing concerns regarding the proper role of government and the level of government at which services should be designed, administered, and financed. Federal expansion into areas that had once been outside the public domain or left to state or local governments was especially pronounced during the Depression and again during the 1960s and early 1970s.

Federal spending for grants grew continuously from the 1950s until 1981, but dropped in 1982. Grants spending in real terms--after adjustment for inflation--has been dropping since 1978, due to slow growth in benefit payments for individuals and a substantial decline in spending for other grant programs (see Figure 4).

Figure 4.

Federal Grants, 1940-1982

SOURCE: Office of Management and Budget.

The Depression Years--Growth of the Federal Government

The first major increase in the role of the federal government relative to nonfederal governments occurred during the 1930s, as the result of the Depression. The doubling in the size of government from 1929 to 1939--with spending by all levels of government increasing from 10 to nearly 20 percent of GNP--was due largely to increased spending by the federal government. During this time, the federal government channeled relief not only directly to individuals, but also to state and local governments that were affected by a combination of Depression-shattered revenue systems, statutory limits on borrowing, and mass unemployment. Spending for federal grants-in-aid grew ninefold from the start of the Depression to 1940, funding public works and general assistance. Many of these grant programs were temporary

measures, however, that were discontinued when World War II and economic recovery began. The principal permanent legacies of the Depression were Social Security and the Unemployment Insurance system--both financed through trust funds rather than grants. 8/

The Postwar Years--Growth of Nonfederal Governments Funded by Federal Aid

By contrast, the years between 1950 and the mid-1970s were characterized by growth of government at all levels with a more extensive increase in the role of the federal government in financing state and local public services. Several factors contributed to this expansion. First, an extended period of rapid economic growth greatly expanded the resources available to governments and helped fuel a growing concern for aiding those persons who were benefiting least from the general prosperity. The range of human services for which governments assumed responsibility expanded in the 1960s from a primary emphasis on income support for certain low-income families and the elderly to include some degree of assistance for all low-income persons (through the Food Stamp program), as well as such other services as education and training for the disadvantaged, medical care for the elderly and the poor, and housing assistance for lower-income families. In addition, entirely new policy goals were adopted by the federal government, including the development of an interstate transportation network in the 1950s and the reduction and control of environmental pollution in the 1970s. As a result, spending by all levels of government increased by about 60 percent, relative to the economy, between 1950 and 1975, growing from 21 percent to 35 percent of GNP.

Concurrent with this broadening in the scope of government, a number of concerns developed regarding the ability and willingness of states and localities to provide certain services. For one thing, it was recognized that different jurisdictions had seriously unequal resources with which to finance services. Further, not all states and localities were viewed as equally responsive to the needs of their citizens--particularly the poor and minorities. In addition, it was widely felt that many governments lacked the administrative capacity to assume full responsibility for providing certain types of services. Finally, it was recognized that individual states lacked the incentive to address certain of the newly adopted national policy

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8. See George Break, "Fiscal Federalism in the United States: The First 200 Years, Evolution and Outlook," Chapter 3 in The Future of Federalism in the 1980s (Advisory Commission on Intergovernmental Relations, July 1981), pp. 44-45.

objectives, such as developing a nationwide transportation network or dealing with interstate air and water pollution.

Financing services through federal rather than state and local revenues appeared to have several advantages. Since the federal taxes imposed to pay for the services would be uniform across states, the reluctance that state and local governments might feel about raising taxes to expand public services--for fear that businesses and high-income taxpayers might relocate to other areas with low-tax economic climates--would be reduced. In addition, some redistribution of revenue resources, from states with high fiscal capacity to those with low capacity, would be possible, depending on how spending allocations were determined. Finally, the tax burden would be shifted toward higher-income persons by substituting the federal income tax for the sales and property taxes that states and localities relied on heavily during this period, and that were generally less progressive than the income tax.

These factors--the emergence of new national objectives, concerns about the capacity of nonfederal governments to address those objectives, and the perceived advantages of federal financing--led to expansion in the federal system of grants-in-aid. During the period from 1950 until the middle 1970s, new grants providing payments for individuals were created--including Medicaid--while spending was increased sharply for previously existing programs. In addition, a number of new categorical human service grants were enacted, typically to provide services not previously available--such as job training for the disadvantaged--or to increase the level of services available to some disadvantaged group--as in the case of compensatory education. Finally, these years saw the creation or expansion of grant programs designed to address the newly adopted policy objectives in the transportation and environmental areas.

The 1970s--Growing Dissatisfaction with the Grants System

By the early 1970s, the policy focus had begun to shift. For one thing, while some of the concerns that gave rise to the growth in grants persisted--such as the inequality of resources among states and their lack of incentive to address certain national policy objectives--other concerns had lessened, particularly regarding the administrative capacity of states and their reliance on nonprogressive taxes.

In addition, the grants system was itself increasingly viewed as a problem. Some thought that the federal government was overcommitted, with poorly coordinated programs in too many areas at too great expense. There was dissatisfaction with badly managed, ineffective programs that

were thought to result from the sharing of responsibilities among levels of government, so that no level of government could be held accountable. There was dislike of federal intrusion on state and local prerogatives, effected through program regulations and the threat of withdrawal of federal funding from recipient governments that did not comply. Finally, there was unhappiness with the instability of federal funding, which made it difficult for recipient governments to plan for continuing programs, and which subjected them to pressure by affected interest groups to continue activities after federal funding was terminated or substantially reduced. 9/

Dissatisfaction with the grants system prompted a number of changes beginning in the 1970s. First, in 1972 the Congress authorized the General Revenue Sharing (GRS) program, which provided states and local units of government with federal grant dollars to be used for any purposes they chose, subject only to federal requirements that there be public participation in the decisions and that the activities supported be nondiscriminatory. 10/ In addition, some existing narrow-purpose categorical grants were consolidated into less restrictive block grants. Examples include the Title II-B and C programs of the Comprehensive Employment and Training Act (enacted in 1973), the Community Development Block Grants program (1974), and the Grants to States for Services (now the Social Services Block Grant) under Title XX of the Social Security Act (1975). These actions expanded the discretion available to states and localities to design suitable approaches to their problems, while reducing the control the Congress could exercise over program activities.

As a result of these initiatives, the share of federal grant outlays that were general-purpose or broad-based rose from 10 percent in 1972 to 23 percent in 1976. By 1981, however, general-purpose and broad-based grants had fallen to only 18 percent of all grant funding due to the decline in funding for GRS, the slow growth in funding for broad-based grants, and the somewhat faster growth of narrow-purpose categorical grants (see Table 2).

The 1980s--Renewed Efforts to Change the Grants System

Since taking office, the Administration has made a number of proposals intended not only to reduce federal spending for domestic purposes

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9. Many of these concerns were first raised in the 1950s, when the Kestnbaum Commission, appointed by President Eisenhower, recommended separating revenue sources and sorting out functions among the levels of government.

10. After 1980, the state share of GRS was eliminated.

TABLE 2. OUTLAYS FOR GENERAL-PURPOSE, BROAD-BASED, AND OTHER GRANTS, SELECTED YEARS

	1972	1976	1980	1981	1982
			Billions of Dollars		
General-purpose Grants:	0.5	7.2	8.6	6.8	6.5
General revenue sharing	(0.0)	(6.2)	(6.8)	(5.1)	(4.6)
Other	(0.5)	(0.9)	(1.8)	(1.7)	(1.9)
Broad-based Grants a/	2.9	6.2	10.3	10.0	11.5
Other Grants	31.0	45.8	72.5	77.9	70.2
Total	34.4	59.1	91.5	94.8	88.2
			Percent Distribution		
General-purpose Grants	1.5	12.1	9.4	7.2	7.4
General revenue sharing	(0.0)	(10.6)	(7.5)	(5.4)	(5.2)
Other	(1.5)	(1.5)	(1.9)	(1.8)	(2.2)
Broad-based Grants a/	8.3	10.4	11.3	10.6	13.0
Other Grants	90.2	77.5	79.3	82.2	79.6
Total	100.0	100.0	100.0	100.0	100.0

a. Office of Management and Budget. The category of broad-based grants, as defined by the Office of Management and Budget, includes Community Development Block Grants, various health block grants, Title II-B,C of the Comprehensive Employment and Training Act, the Social Services Block Grant, the Community Services Block Grant, Low-Income Home Energy Assistance, the State Education Block Grant, and Impact Aid.

relative to spending for defense, but also to restructure the system of federal grants-in-aid. In 1981, the Administration proposed consolidation of a large number of categorical grants, and substantial consolidation was achieved. In 1982, the Administration proposed a major realignment of programs in which the federal government would assume full financial responsibility for some Medicaid services, while AFDC and some grant programs in education, health, social services, transportation, and community development would be "turned back" to the states which would have to assume full financial responsibility for them--or terminate them--after a transitional period. 11/ Negotiations with the states over this proposal failed to reach agreement, in part because of an inability to agree on how to federalize Medicaid. The Administration's proposals in 1983 were far more modest, calling for more grant consolidation.

Although few of the Administration's 1982 and 1983 proposals for the grants system have been enacted, many of its 1981 proposals were--at least in modified form. In 1981, in addition to reducing the funding for numerous non-entitlement grants and eliminating some others, the Congress created nine new block grants from 57 previously existing categorical programs. Four of the new block grants were for health care, while one each was for education, community services, community development, social services, and energy assistance. Under the new block grants, federal requirements in the previously existing grants for targeting the use of funds and for reporting were weakened. In all, the number of grant programs was reduced by 22 percent, from 360 in 1981 to 280 in 1982. 12/ In addition, changes were made in the largest entitlement grant programs--AFDC and Medicaid--that slowed spending increases by tightening eligibility and shifting more costs to the states.

In 1982, two new block grants were created--one to replace previous job training programs and another for mass transit that replaced an antecedent four-tiered program. Spending for most non-entitlement grants was frozen at the level set for the previous year. No substantial changes were made in entitlement grant programs, so that funding for them generally increased with the growth in the number of recipients and with cost-of-living adjustments in a few of them.

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11. In its original proposal, the Administration suggested assigning full financial responsibility for the Food Stamp program to the states as well, but this was later eliminated from the proposal in the process of negotiations with the states.

12. Estimates by the Office of Management and Budget.

TABLE 3. GRANT OUTLAYS BY PROGRAM AREA: 1981, 1982 AND 1983 (In billions of dollars)

Program Area	Actual 1981	Actual 1982	Estimated 1983	Percent Change in Real Terms 1981-1983
Infrastructure and Development	25.1	22.9	23.3	-15
Education, Employment, and Social Services	21.1	16.6	17.3	-29
Income Security and Health	40.2	40.8	45.5	-2
General-purpose Fiscal Assistance	6.7	6.3	6.3	-18
Other a/	1.7	1.6	2.3	+18
Total	94.8	88.2	94.7	-12

SOURCE: Congressional Budget Office.

a. Includes grants for national defense, agriculture, commerce, veterans' programs, administration of justice, and general government.

As a result of these actions, estimated outlays for grants in 1983 are about equal to the 1981 level in nominal terms, but are 12 percent less in real terms, after adjustment for inflation (see Table 3). By program area, real spending was reduced by 15 percent for infrastructure and development grants; by 29 percent for education, employment, and social service grants; and by 2 percent for income security and health grants.

The real decline in funding for federal grant programs has added to the already serious budgetary problems in many states, which are due principally to the recent recession and to spending or taxing restrictions recently

imposed by the voters in some states. 13/ One study of state and local responses to federal grant reductions in 1982 indicates that willingness to replace lost federal aid varied by type of program, with redistributive programs faring poorly and capital programs for local infrastructure doing well. Cuts in entitlement programs--AFDC and Medicaid--were generally ratified, or passed on to benefit recipients. Some cuts in human service programs were ratified, while others were replaced, at least partly. Replacement was more likely in programs that were not focused only on the poor, and in programs that had lobbying support from organized groups of beneficiaries or providers. States replaced some funding for day care, home care for the elderly, and health services (under the new block grants) because of these factors, apparently. Capital programs for infrastructure also benefited from generalized political support--because they typically affect all income groups--as well as from lobbying efforts by builders and their suppliers. 14/

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13. A fiscal survey of the states released by the National Governors' Association and the National Association of State Budget Officers in May 1983 shows that aggregate balances for states are expected to be only 0.2 percent of expenditures at the end of fiscal year 1983, down from 9.0 percent at the end of 1980. Fifteen states are expecting zero or negative balances by the end of fiscal year 1983, and only four states are predicting balances in excess of 5 percent of expenditures, which is considered to be the minimum prudent level.

14. Richard P. Nathan, and Fred C. Doolittle, The Consequences of Cuts: The Effects of the Reagan Domestic Program on State and Local Governments (Princeton Urban and Regional Research Center, 1983).

CHAPTER IV. PUBLIC WORKS INFRASTRUCTURE AND DEVELOPMENT PROGRAMS

Over the years, the federal government has assumed a major role in supporting public works infrastructure such as dams and highways, and in financing capital improvements to assist community and economic development. 1/ In many cases, however, investment priorities have shifted since these programs were first framed, and some of the original rationales for extensive federal involvement may no longer apply. A number of infrastructure programs were designed to achieve important development goals that have now largely been met--such as building a national network of highways, fostering the growth of western agriculture, and constructing a system of locks and dams. Today, as federal policies are being revised to reflect shifting needs, it may be useful to consider a realignment of existing federal, state, and local roles. Such a review is especially timely now, when tight budgetary constraints are forcing all levels of government to reevaluate their priorities in light of the need for more effective spending.

All levels of government have been involved in financing, building, and managing infrastructure facilities, and in supporting community and economic development programs. Historically, the federal government has strongly influenced the pattern of state and local investment, both by providing significant financial incentives (such as a high federal share of matching grants) for certain types of investments and by establishing regulatory standards. The federal role has been based on concern with one or more of the following, as discussed in Chapter II:

- o Spillovers or external effects;
- o The advantages of centralized coordination; and
- o The development and more equitable distribution of resources.

A reduced federal role may be warranted in areas where there are no significant spillovers (since there would be relatively small nationwide

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1. For detailed analysis of the adequacy of current federal public works infrastructure programs, see Congressional Budget Office, Public Works Infrastructure: Policy Considerations for the 1980s (April 1983).

benefits) or where there is no need for central coordination. A continued federal role may be justified in areas where capital financing needs are so large as to require federal backing, or if there are major inequities or hardships to be addressed.

This chapter contains three major parts. The first describes the basis for federal involvement in infrastructure and development programs, and the second examines the current federal role in light of these basic rationales. 2/ Part three develops a number of specific options the Congress might consider that would realign the financing and management responsibilities of federal, state, and local governments in these areas.

BASIS FOR FEDERAL INVOLVEMENT

The three basic criteria for federal involvement are reviewed briefly below, and in the following section are applied to current federal programs for highways, transit, airports, water resources, wastewater treatment, and community and economic development.

Spillovers or External Effects

Where the costs or benefits of public activities flow across state borders, individual states may lack the incentive to deal with them adequately. For example, states may build wastewater treatment plants that efficiently serve their own needs but discharge harmful pollutants downriver to neighboring states. By offering substantial financing aid for wastewater treatment works, the federal government induces states to build sufficient capacity to prevent harmful spillovers, thereby reducing costs to the economy as a whole.

Centralized Coordination

In some cases, centralized planning and management of public works facilities are needed to improve economic efficiency and ensure a coordinated national network. Notable examples are the Interstate Highway System and the air traffic control system. In the early days of aviation, local governments operated their own air traffic control towers; today, the federal government equips and operates the entire system, reducing administrative costs and ensuring safe air travel.

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2. Additional background on these programs is provided in Appendix A.

Development and Distribution of Resources

Historically, a major goal of federal investment in infrastructure has been to encourage regional development, and thus foster the growth of the economy as a whole. For example, federal provision of irrigation facilities at the turn of the century was designed to accelerate the development of the West. More recent federal programs have sought to help regions meet severe local financing problems. These include federal programs that assist urban areas in financing infrastructure projects with large initial costs, such as the construction of new subways, as well as community and economic development programs intended to help distressed areas develop the resources required for sustained economic growth.

In recent years, the federal government has also subsidized activities that benefit disadvantaged groups such as the poor and the handicapped. Thus federal subsidies for urban public transit are often seen as (among other things) a means of helping the poor, the elderly, and the disabled. Federal aid for community development is often limited to projects benefiting low-income households.

THE CURRENT FEDERAL ROLE

Federal programs supporting public works infrastructure--defined here as highways, mass transit systems, airports, water resources (ports and harbors, inland waterways, and multipurpose dams), and wastewater treatment plants--have helped build and maintain the physical framework necessary for the nation's continued economic growth and stability. 3/ Today, this framework is largely in place, and investment priorities are shifting from new construction to the repair, rehabilitation, and replacement of existing facilities. In addition, the federal government provides specialized aid for community and economic development: programs intended to foster improved living environments, especially for the urban poor, by financing a wide range of capital improvements; and projects aimed to encourage development in distressed areas, such as inner city neighborhoods and Appalachia.

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3. Two additional systems--air traffic control and water supply--are not discussed in detail in this chapter, because either a dominant federal role appears to be required (air traffic control) or local interests predominate (municipal water supply).

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Capital spending by all levels of government for public works infrastructure was about 1.3 percent of gross national product (GNP) in 1980, as compared to 2.2 percent in 1960. 4/ The federal share of this spending has increased, however--from more than one-third in 1960 to over one-half in 1982. Most of this growth resulted from two new federal grant programs, for wastewater treatment and mass transit. The increased federal role in these areas offset a real decline in federal spending for highways, which was recently reversed with passage of the Surface Transportation Assistance Act of 1982.

In 1982, $19.3 billion in federal funding--including grants to states and localities and direct expenditures--was authorized for the five infrastructure systems considered here (see Table 4). With the increased authorizations for highways and mass transit enacted in the Surface Transportation Assistance Act of 1982, federal funding will rise to $25.4 billion in 1983. The scope of federal participation in the different infrastructure programs varies markedly (see Table 5). For example, the federal government's share of total capital spending ranges from about 20 percent for construction at commercial airports to 100 percent for the dredging of ports and inland waterways. For programs that provide matching grants to states and localities, the federal government covers anywhere from 50 to 95 percent of individual project costs. Funding mechanisms are equally diverse, including user fees, appropriations from general funds, and various forms of interest subsidies. The extent to which infrastructure programs recover federal costs through fees charged to direct users of these facilities ranges from about 6 percent for inland waterways to about 95 percent for highways; in many programs, including ports, mass transit, and wastewater treatment, no federal costs are recovered through user fees.

Federal spending for community and economic development in 1982 totaled $4.1 billion (see Table 4), and is scheduled to rise to $5.2 billion largely as a result of additional commitments included in the 1983 Emergency Jobs Appropriation Act (P.L. 98-8). Much community development funding is provided on a formula basis to large cities and urban areas, for capital improvements such as housing rehabilitation and water and sewer repair. The federal government does not require that localities directly match the community development funds they receive. Economic development aid has historically been targeted to areas with low incomes such as communities in the South and Appalachia, but in more recent years

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4. Including air traffic control and water supply. If these two systems are excluded, capital spending by all levels of government similarly represents a declining percentage of GNP, and the federal share of this spending increases.

TABLE 4. FEDERAL FUNDING FOR SELECTED PUBLIC WORKS INFRASTRUCTURE AND DEVELOPMENT PROGRAMS
(In billions of dollars of budget authority)

Program Area	Predominant Type of Spending	1982	1983
Public Works Infrastructure			
Highways	Grants to states	8.9	13.5
Public transit	Grants to localities	3.7	4.3
Airports	Grants to localities	0.5	0.8
Water resources	Direct expenditures	3.8	4.3
Wastewater treatment	Grants to localities	2.4	2.5
Total		19.3	25.4
Community and Economic Development			
Community development	Grants to localities	3.5	4.5
Economic development a/	Grants to localities	0.6	0.7
Total		4.1	5.2

SOURCE: Congressional Budget Office.

NOTE: This table does not include federal tax expenditures or credit support programs. In 1982, the federal government spent an estimated $8.5 billion in tax expenditures for public works infrastructure and development (largely tax revenues forgone on tax-exempt infrastructure bonds and small issue industrial revenue bonds). New loan and loan guarantee obligations totaled about $0.6 billion and $0.3 billion, respectively.

a. This excludes specialized economic development aid, such as grants to Indian Tribes, and the Tennessee Valley Authority.

has expanded to include places undergoing shifts in their economic bases, as in some parts of the Northeast and Midwest. Although in the past much assistance was given directly to private firms, aid is now generally focused on states and localities to help provide the public services necessary for

TABLE 5. FEDERAL FINANCING AND PROJECT RESPONSIBILITY FOR SELECTED PUBLIC WORKS INFRASTRUCTURE AND DEVELOPMENT PROGRAMS

Program Area	Federal Share of Total Capital Spending	Source and Type of Federal Funds	Federal Share of Matching Grants	Project Selection	Project Construction and Management
Highways	About 30 percent of total spending on roads, including maintenance; 50 percent for construction and major repairs on Federal-Aid System	Trust fund (95 percent); general fund (5 percent); formula and discretionary grants	75-95 percent for capital grants (new construction and major repairs)	State and local governments (subject to FHWA regulations); Interstate routes chosen by federal government in consultation with states	State and local governments; some toll roads
Public Transit	About 75 percent	Trust fund (25 percent) general fund (75 percent); discretionary and formula grants	75-85 percent for capital grants; 50 percent for operating assistance grants	Transit authorities (subject to UMTA approval)	Transit authorities
Airports	About 20 percent for construction at commercial airports; about 85 percent for general aviation airports	Trust fund; formula and discretionary grants	50-94 percent	Airport authorities, in conjunction with airlines	Airport authorities

(Continued)

TABLE 5. (Continued)

Program Area	Federal Share of Total Capital Spending	Source and Type of Federal Funds	Federal Share of Matching Grants	Project Selection	Project Construction and Management
Water Resources	About 75 percent for dams; 100 percent for dredging of ports and inland waterways	General fund; direct expenditures	Not applicable	States and federal government (ports); federal government, with state and local input (waterways and dams)	Federal government (waterways, dredging of ports, dam construction); federal and state agencies (dam management)
Wastewater Treatment	About 70 percent	General fund; project grants	75 to 85 percent a/	Local agencies with state or EPA assistance	Localities
Community Development	b/	General fund; formula and discretionary grants	Not applicable	Local and state governments	Localities
Economic Development	b/	General fund; discretionary grants	Not applicable	Federal government	Localities

a. For fiscal year 1985 and thereafter, the federal match will be 55 percent for conventional systems and 75 percent for "innovative" systems.

b. The federal government pays 100 percent of the community development projects it assists and from 13 to 90 percent of selected economic development projects. Federally aided projects are only a share, however, of total community and economic development investment.

economic growth. The federal government generally provides from 13 to 90 percent of economic development project costs, with state and local governments or the private sector providing the balance (see Table 5).

Highways

The federal government spends more on highways and bridges than on any other component of the nation's infrastructure. For 1983, federal funding will be about $13.5 billion, or roughly half of the federal government's total spending for public works infrastructure. Federal funds come from the Highway Trust Fund, which is supported by a series of user taxes, most importantly the nine-cent-per-gallon federal tax on motor fuels. 5/

Since 1923, the Federal-Aid System of highways has grown from 169,000 miles or 5 percent of the nation's roads to 820,000 miles and over 20 percent of the route-miles. The Federal-Aid System now includes 40,000 miles of Interstate routes, 260,000 miles of major Primary System arterials, 400,000 miles of collector routes in rural areas (the Secondary System), 125,000 miles in the Urban System, and 260,000 bridges. The Interstate System, which represents only 1 percent of the nation's roads, alone carries about one-fifth of all traffic, and is now over 95 percent complete. In contrast to the rest of the nation's highway system, where states have basic responsibility for selecting routes to be built, the federal government approves which routes are eligible to be parts of the Interstate program and provides the funds to build these routes on unusually attractive terms--at least 90 percent of costs paid for by the federal government. 6/

Over the years, the definition of the Interstate System has expanded to include many roads that are of greater interest to states and localities than to the federal government. This is largely because the financial advantages conferred on states by the 90 percent federal match for Interstate highway construction encouraged states to build many highway projects that are unnecessary from a national perspective. Today, over 70 percent of the cost of completing the Interstate is for routes of predominantly local importance--routes that are not part of the network

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5. See Congressional Budget Office, Financial Options for the Highway Trust Fund (December 1982).

6. The federal matching share for most non-Interstate highway programs is now 75 percent.

necessary to link principal cities together, but that link facilities of regional importance or improve traffic circulation in urban areas. 7/

In addition to the Interstate System, federal funds also support the Primary, Secondary, and Urban systems, the Bridge Replacement and Rehabilitation program, and a variety of safety and other specially targeted programs. Federal grants account for about 70 percent of capital spending for the Primary System, which is composed largely of significant intercity arteries in rural areas, carrying twice as much interstate traffic as the Interstate System. By contrast, federal spending represents only about 20 percent of total government capital spending on the Secondary and Urban systems. Federal aid has relatively little influence on the total amounts spent for these locally oriented systems. States and localities carry most of the burden for these systems, for roads that are not included in any of the various federally assisted programs, and for routine maintenance--such as grass mowing and pothole filling--on all road systems.

Effects of Current Programs. The most basic rationale for federal involvement in highways rests on the need for a coordinated national network of roads to facilitate interstate commerce. Because the benefits from such a system extend beyond individual states, federal financial aid is required to ensure that an adequate interconnected network is built. Although some parts could be self-supporting as toll roads, the network as a whole requires government support.

The extent of national interest in the different highway programs varies considerably, however. The major federal interest is centered on the Interstate and Primary systems, and on related bridges--roads that link activities in different states and contribute to interstate commerce. Aid for the rest of the Federal-Aid System can be considered a form of intergovernmental subsidy.

Although the size of the current federal commitment is roughly in line with the needs for highway infrastructure, federal programs could be better targeted to promote effective investment. 8/ For instance, the most significant national highway problem appears to be the deteriorating condition of the Interstate System and certain other important parts of the Federal-Aid network. Repairing these key commercial routes is of higher national

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7. See Congressional Budget Office, The Interstate Highway System: Issues and Options (June 1982).

8. See Congressional Budget Office, Public Works Infrastructure: Policy Considerations for the 1980s, Chapter II.

priority than building remaining Interstate routes that are primarily of local or regional importance. Under current policies, however, the federal government continues to spend large sums--about $4.5 billion was authorized in 1983--for Interstate completion, even though less than half of the remaining cost of the Interstate network is related to constructing an interconnected system of intercity roads. In addition, over $2 billion in federal funds is devoted annually to the locally oriented Secondary and Urban systems and to programs representing a mix of safety, economic development, and special regional concerns of particular interest to state and local governments, which are in the best position to make effective project choices.

Public Transit

Federal funding of mass transit began in the early 1960s, mainly to help localities purchase failing private bus lines and upgrade their equipment. Then, during the early 1970s, federal capital aid increased rapidly, permitting greater use of funds for existing and new rail systems. In many cities, fares were held down to encourage ridership; and, as transit systems expanded, labor and other costs rose dramatically. As a result, operating deficits grew until most systems were relying on the farebox for less than half their operating costs. As this burden increased, operating subsidies were added to the federal program in 1975.

With the dedication to transit of one cent of the new five-cent-per-gallon tax on motor fuel, the federal government will provide about $3.4 billion in capital grants for public transit in 1983, and an additional $0.9 billion in operating assistance grants. With the exception of some projects in a few large cities, almost every transit capital project uses federal aid, with a 20 percent nonfederal match (25 percent beginning in fiscal year 1984). Capital grants are used for four basic purposes: new bus purchases and bus maintenance facilities; modernization of existing rail transit systems; extension of existing rail transit systems; and construction of new rail systems. Federal operating grants cover about 13 percent of transit operating costs nationwide.

In contrast to most other federal infrastructure programs, virtually all federal transit grants are made to local rather than state governments, and local governments are largely responsible for project selection and management. Grants administered by the Urban Mass Transportation Administration (UMTA) are of two types--project grants for rail- and bus-related capital projects, made at the discretion of the UMTA Administrator; and formula grants for operating assistance and routine capital investments such as bus replacement. Capital funds are also provided by "Interstate substitu-

tion" grants for cities that have decided not to build specific segments of the Interstate Highway System. 9/

The Surface Transportation Assistance Act of 1982 created a modified transit block grant program that will go into effect in fiscal year 1984. The new transit block grant will replace UMTA's existing urban formula grant program, which provides funds for operating assistance (the bulk of the program) and for capital uses such as routine bus replacement. Block grant funds can be used for capital or operating purposes, with the annual amount available for operating assistance in 1984-1986 limited to a specified percentage of each urbanized area's 1982 operating apportionment.

Effects of Current Programs. In contrast to most other federally assisted infrastructure programs, the benefits from mass transit are predominantly local. Therefore, federal assistance to transit rests on a federal decision to assist urban areas and on the perception that, without such help, localities could not afford all the capital investment necessary to build and maintain public transportation systems. In response to this perception, the federal government has provided high federal capital grants--covering 80 percent of project costs through fiscal year 1983, and 75 percent thereafter. 10/ This generous federal share, usually augmented by state money, gives local authorities an incentive to start new capital-intensive transit systems and to buy new equipment rather than invest in the continued maintenance and repair of existing facilities. After federal and state contributions, local governments may pay only 10 percent of total project costs.

Federal aid to mass transit, including operating assistance, has also been justified on grounds that transit can help attain several important social and economic objectives. These include easing urban road traffic congestion, saving energy, reducing pollution, and providing people without cars access to jobs. But recent studies indicate that many of these objectives are not realized. For example, reductions in public transit fares appear to have little effect on traffic levels in urban areas, even though the

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9. If the Federal Highway Administration agrees with a city's contention that a certain planned Interstate route is not of national significance, the city has the option of using these funds, subject to appropriations, for either transit or other highway projects. In contrast to the rest of the transit program, the federal government has relatively little influence over how or where these grants are used.

10. The federal share for all projects covered by existing Letters of Intent and Full Funding contracts will remain 80 percent.

justification for the transit subsidies required to lower fares includes expected benefits from reduced auto congestion and air pollution. And although a major benefit commonly attributed to new rail lines is reduced road congestion, evidence suggests that new rail systems tend to attract chiefly bus and carpool passengers and thus do not significantly reduce the number of automobiles on the roads. 11/ Similarly, mass transit's benefits to disadvantaged groups, such as the poor, the elderly, and the disabled, are often taken for granted. While this assumption appears valid for such highly specialized services as "dial-a-ride" vans, most forms of mass transit serve predominantly higher-income persons of working age. 12/ In general, it appears that federal transit subsidies have not been very effective in reducing external costs such as road congestion or in alleviating personal hardship.

Airports

The Federal-Aid Airport Program was initiated in 1946 as a means of accelerating the development of a commercially viable aviation system. Today, the Federal Aviation Administration (FAA) manages the user-supported Airport and Airway Improvement Program, through which the federal government makes 50 to 94 percent matching grants for construction and rehabilitation of the nation's airports. For 1983, the federal government has authorized $800 million for capital improvements to airports, and an additional $4 billion has been authorized over the next four years. 13/

Under current policy, virtually every publicly owned airport in the country is eligible to receive federal assistance, including the 780 commercial airports, which are served by scheduled commercial air carriers or by commuters and air taxi operators, and the 2,379 general aviation

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11. See, for example, Institute of Public Administration, Financing Transit: Alternatives for Local Government, prepared for U. S. Department of Transportation (July 1979), pp. 9-10.

12. See Robert B. Cervero and others, Efficiency and Equity Implications of Alternative Transit Fare Policies, prepared for U.S. Department of Transportation (September 1980), and Congressional Budget Office, Urban Transportation for Handicapped Persons: Alternative Federal Approaches (November 1979).

13. The Congress has imposed obligation ceilings of $750 million for 1983 and $800 million for 1984.

airports, used exclusively by small planes owned by individuals and private corporations for recreational or business use. Of the 780 commercial airports, the 66 largest serve about 90 percent of all air passenger traffic. And only 155 general aviation airports--designated as "reliever" airports--are needed to help reduce congestion at major commercial airports. The remaining 2,224 general aviation airports serve predominantly local needs. 14/

Effects of Current Programs. Historically, the federal government helped stimulate the commercial aviation system by making capital grants for airport development. Today, every major city has an airport, and the dependence on federal aid varies greatly. Direct federal funds now appear to account for 20 percent or less of total investment monies at large airports, the balance being drawn from the issuance of tax-exempt bonds, retained earnings, and other nonfederal sources. With major airports rated in the municipal bond market as premium investments, these airports might easily finance further improvements without federal aid. By contrast, many small airports, especially general aviation airports, earn insufficient revenues to cover debt service, and these tend to rely much more heavily on federal funding. A sizable number of general aviation airports currently do not charge landing fees, and have only minimal charges for the use of parking tie-downs and other facilities; many could substitute such fees for existing federal grant assistance. Except in the case of reliever airports that help reduce congestion at major commercial airport facilities, there appears to be little economic justification for the extensive federal support of general aviation airports, given their limited contribution to a national transportation system and their substantial, untapped revenue-raising potential.

Water Resources

Since the early years of the nation's history, the federal government has been involved in financing, constructing, and operating a variety of water resource projects, including inland waterways (locks, dams, and

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14. These are included in the National Airport System Plan and eligible for federal aid based on the FAA's broad definition of national significance. According to this definition, a general aviation airport has national significance if it is publicly owned, has at least 10 based aircraft, and serves a community located 30 minutes or more from another existing or proposed airport in the National Airport System Plan.

channel dredging), ports and harbors, and multipurpose dams. 15/ For 1983, $4.3 billion in direct federal expenditures have been authorized in these areas, including construction, operation, and maintenance.

The federal government, largely under the auspices of the U. S. Army Corps of Engineers, plays a dominant role in building and maintaining the nation's water resources public works. For most types of projects, the federal government finances all capital costs but ultimately pays somewhat less because of reimbursements from users and other nonfederal contributions. For the average inland waterway project, the federal government pays about 94 percent of combined capital and operating costs over the project's life. For multipurpose dam projects, the federal share averages 70 percent of combined costs, but may range anywhere from about 36 percent for a single-purpose hydroelectric project to 89 percent for an irrigation project. The federal government's share of costs for a typical commercial harbor project is approximately 84 percent. 16/

Effects of Current Programs. Historically, the federal government's role in water resources has been based extensively on the goal of promoting regional economic development. For example, the federal government built the system of inland waterways when no other transportation mode existed to serve growing industry and agriculture in the South and Midwest. With the maturing of regional economies and the completion of most water projects necessary to achieve regional development goals, some of the major concerns motivating federal subsidization of water resources infrastructure no longer apply. Nevertheless, large federal subsidies have continued, even in areas where there are significant opportunities for user fee financing. For instance, under current policy, local sponsors pay only 11 percent of the cost to construct dams for irrigation purposes, and the federal government continues to provide heavily subsidized irrigation water to western farmers--a subsidy that has outlived its original purpose of hastening the development of the West. Similarly, although freight shipping on inland waterways has become a mature business, federal subsidies today cover more than one-fourth of the costs of the barge industry--more than ten times the share of federal subsidies for other modes of transport. Continuation of federal subsidies for water transport encourages the use of barges

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15. Multipurpose dams serve several functions, including flood control, irrigation, navigation, hydroelectric power generation, municipal and industrial water supply, and recreation.

16. For further details, see Congressional Budget Office, Current Cost-Sharing and Financing Policies for Federal and State Water Resources Development (July 1983).

rather than railroads, and this in turn stimulates demand to build more locks and dams with federal dollars.

Several other concerns have provided a basis for federal involvement in certain water resource projects: national defense and security (ports and harbors); the benefits of centralized coordination (inland waterways, multi-state reservoir systems); and the presence of external costs and benefits, as in water quality or flood control. Most of the federally important water projects have already been built, however; future water resource needs will be concentrated on the management and rehabilitation of existing facilities, with smaller intrastate projects likely to dominate new construction.

Wastewater Treatment

While the federal government has provided some grants for wastewater treatment facilities since the late 1950s, the extensive federal role in wastewater treatment grew out of the awakened national concern for preserving and improving environmental quality in the 1960s and 1970s. The 1972 Water Pollution Control Act sought to achieve "fishable and swimmable" waters by 1983 and to eliminate pollution of navigable U.S. waters by 1985. The Construction Grants program administered by the Environmental Protection Agency (EPA) was designed to achieve specific, federally mandated pollution abatement goals nationwide, within a strictly limited time-frame. To attain these goals, the federal government undertook to pay 75 percent of the capital costs of constructing or improving publicly owned wastewater collection, treatment, and disposal works.

Since peaking in the late 1970s, annual authorizations for this program have dropped to $2.4 billion in 1983. The federal matching share will decrease from 75 percent to 55 percent of project costs beginning in fiscal year 1985. In addition to their matching share of EPA grants for capital improvements, localities pay all costs of operating and maintaining these systems. Recently, many states have initiated grant and loan programs to help local jurisdictions meet their capital requirements for wastewater treatment.

Effects of Current Programs. The rationale for federal involvement in wastewater treatment rests largely on the presence of significant external costs and benefits. The benefits of wastewater collection and treatment systems accrue both to primary users and to downstream communities. Building adequate facilities solves local wastewater collection and water quality problems, but clean water also benefits others downstream who pay nothing for it. Consequently, no single community would be willing to charge its residents the full cost of wastewater treatment. Thus the

responsibility for maintaining clean rivers, lakes, and streams is shared both by direct users and by all levels of government.

Beginning in fiscal year 1985, financing responsibility will be divided more evenly than at present as the federal share on EPA grants will drop to 55 percent. A drawback of existing federal policy, however, remains its inflexibility in certain situations. In effect, wastewater treatment equipment must be installed to achieve cleaner bodies of water regardless of local water quality or hydrological conditions. In some situations, however, water quality is more directly linked to sources of pollutants other than wastewater, and in others natural processes can make extensive treatment unnecessary. In these cases, capital-intensive wastewater treatment may not achieve higher water quality. More flexible federal standards would allow localities to implement more cost-effective solutions.

Community Development

Federal community development programs support a wide range of local improvements to public and private facilities. Most aid is channeled through the Community Development Block Grant (CDBG) program administered by the Department of Housing and Urban Development (HUD). The rest is provided through the Farmers Home Administration (FmHA) within the Department of Agriculture.

The CDBG program, begun in 1974, was a major federalism initiative of the Nixon Administration, under which seven categorical programs for community development were consolidated into a block grant. 17/ These earlier programs were considered ineffective because their specialized nature prevented local governments from tailoring uses to respond to local conditions and because the federal government could not weigh the advantages of different approaches in distributing funds. The consolidation of these programs into a block grant was intended to allow communities considerable flexibility in designing strategies to meet local development needs.

Funding for the current CDBG program is set at $4.5 billion, including $1.0 billion from the supplemental jobs bill. About 70 percent of funds are provided by formula to urban cities and counties, and the remaining funds

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17. The programs included the urban renewal, neighborhood development, Model Cities, water and sewer facilities, neighborhood facilities, public facilities, and urban beautification programs administered by HUD.

are distributed through project grants to smaller communities. Cities with populations over 50,000, the designated central cities of metropolitan areas, and urban counties are entitled to funds, with the amount received depending on a community's need (measured by such factors as the extent of poverty and the age of its housing stock) relative to the needs of other eligible communities. Funds for smaller communities are allocated to state governments, which design and manage mechanisms for allocating funds. 18/

Recipients of CDBG funds are allowed wide latitude in determining the use of funds. In general, CDBG funds must be used for development activities that either eliminate slums and blight, conserve the housing stock, or meet other urgent needs, and that provide benefits primarily for low- and moderate-income households. Of formula grants provided to larger communities, about one-third is used for housing rehabilitation, usually through grants or reduced-interest loans to low- and moderate-income homeowners to make needed repairs. About one-quarter of the money is used for public facilities projects, including: street and sewer repair; solid waste disposal; flood and drainage facilities; and neighborhood facilities such as senior citizens' centers and parks. The remaining funds are used for widely varying activities, such as social services and economic development activities. Although smaller, nonentitlement communities undertake the same types of activities, over 40 percent of their funds are used for public facilities, while housing assistance represents only one-tenth of the total.

Some community development assistance is also provided by the Farmers Home Administration (FmHA), which makes loans for the development of community facilities. Loans may finance a variety of facilities, such as fire stations, hospitals and nursing homes, city halls, and schools. The interest rate charged on loans is determined by the income of a community's residents and currently varies from 5.0 to 9.125 percent. This assistance is limited to rural areas, with funds allocated by the FmHA on a discretionary basis. Funding for community facility loans is set at $130 million in 1983.

Effects of Current Programs. While the CDBG program provides fiscal relief for large urban governments, its primary role is as a means of fostering better living environments, especially for the urban poor. CDBG is the largest source of federal aid that many cities receive, representing

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18. The participation of state governments in the CDBG program is optional; if a state decides not to participate, HUD awards funds to local governments in the state. In 1983, 49 states are participating in the program.

nearly one-third of all federal grants made to city governments in 1981. Because funds may be used for activities that are generally local responsibilities--repairing roads and sewer lines, developing parks and recreational facilities, improving sidewalks and open areas--they allow recipients to shift local funds that would otherwise have been needed for these activities to other locally determined priorities. But a majority of activities financed by CDBG are functions not generally undertaken by local governments--particularly the rehabilitation of low-income housing and, to a lesser extent, economic development activities. Further, CDBG funds are primarily used for activities that benefit low- and moderate-income households. Thus, the program is seen as a means to increase the resources available to less affluent urban residents and to improve the quality of their neighborhoods.

Economic Development

A small portion of federal development aid is limited to areas experiencing economic distress. Funds for these areas are provided principally by HUD's Urban Development Action Grant (UDAG) program and through the Economic Development Administration (EDA) within the Department of Commerce.

Current economic development programs provide grants to local governments for projects facilitating business expansion. Through the UDAG program, the federal government makes grants for commercial, industrial, and neighborhood development projects that applicants certify could not proceed in the absence of such aid. Federal funds contribute an average of 13 percent of total project costs, with localities contributing an additional 6 percent and the private sector supplying the balance. Local governments receiving action grants generally use them to help acquire sites, to develop needed infrastructure such as access roads or sewer lines, or to provide low-interest loans for project construction. Projects are selected on a competitive basis by HUD, with applicants restricted to local governments judged to be experiencing economic distress. Funding is set at $440 million in 1983.

Some economic development assistance is also provided through the EDA. EDA activity reached a peak in 1979, when the agency administered over $1 billion in aid, including credit assistance, much of it directed to private firms. In 1983, funding for EDA has been reduced to $298 million for grants (including $100 million from the jobs bill) and $150 million in loan guarantee authority. Grants are made to state and local governments to undertake public works projects, such as the development of industrial sites or the provision of water and sewer facilities, and to provide technical

assistance. Loan guarantees are made to private firms, covering up to 90 percent of the principal and interest of loans made by private lenders for the purchase of fixed assets or for working capital. A share of EDA assistance is used for short-term, labor-intensive construction projects such as renovation or rehabilitation of existing buildings. EDA may provide assistance only for projects located in areas meeting specific standards for distress, which for regular EDA projects are set loosely enough to encompass 80 percent of the nation's population, but which are more restrictive for short-term projects.

Effects of Current Programs. Federal support for distressed areas is designed to provide employment opportunities and foster economic activity where these are lacking, thereby stimulating overall productivity and generating growth. This growth is intended to serve as a catalyst in distressed areas, prompting additional private investment and employment growth, increasing local revenues, and eventually decreasing federal costs such as unemployment compensation and income support payments.

An important issue concerning federal economic development activities is the extent to which federal investment substitutes for spending, either by the private sector or by state or local governments, that would have occurred in its absence. Although substitution is difficult to measure, studies have estimated that, in as many as one-third of all projects financed by UDAG, federal funds may have substituted in part or in whole for other spending. One study of EDA public works projects found that as much as half of the private investment in project areas, if not on the project site itself, would have occurred without the EDA-financed project. 19/ Further, even when federal funds create net additional economic activity, it is difficult to ensure that the resulting benefits, such as increased employment, accrue to those most in need of assistance.

OPTIONS FOR CHANGE

To reflect the shifting priorities and objectives of national infrastructure investment and to encourage better investment decisions, the Congress may wish to consider a number of options that would modify the existing

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19. For a further discussion of federal funds substituting for other investment, see: Department of Housing and Urban Development, An Impact Evaluation of the Urban Development Action Grant Program (1982); and Abt Associates, Inc., Employment and Investment Impacts of EDA Public Works Investments and Implications for Future Evaluation Methodology, Draft Final Report (November 26, 1980).

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federal role in public works and development programs. The principal candidates for such revision are programs in which there are no significant external costs and benefits, in which there is no need for centralized coordination, or which are financially sustainable at the state or local level. The realignment approaches examined here include:

- o Eliminating federal funding of projects with primarily local benefits;
- o Changing funding provisions to reduce the federal share of costs for federally assisted projects;
- o Changing program rules by making federal regulations more flexible;
- o Changing both funding provisions and program rules by consolidating existing programs into block grants; and
- o Encouraging creation of cross-cutting financing mechanisms, such as infrastructure banks.

For the most part, these approaches are independent but not mutually exclusive; some would be most effective if put in place in a complementary fashion. The first two would significantly reduce the federal role in existing programs, while the remaining three would provide increased flexibility and financing resources for states and localities, to enable them to assume greater responsibility for these programs. Each of these approaches is discussed in detail below.

The budgetary impact of the specific realignment options would depend on several factors (see Table 6). In programs presently supported by federal user taxes, a turnback of revenues from existing taxes could eliminate or greatly reduce the financial burden placed on states and local governments. Any turnback of revenues or reduction in federal taxes would, of course, reduce the federal budgetary savings. For states and localities, the increase in financial burden would depend on the institution of state and local user fees, the level of offsetting federal aid, and the demand for infrastructure services.

Eliminate Federal Funding

Limiting federal aid to national needs and shifting decisionmaking and financial responsibility for projects with primarily local benefits to states and localities would be most applicable to four program areas: highways,

TABLE 6. ESTIMATED BUDGETARY IMPACT OF SELECTED FEDERALISM OPTIONS FOR PUBLIC WORKS INFRASTRUCTURE, 1984 (In billions of dollars)

Option	Reduction in Federal Obligations	Increase in Nonfederal Financial Burden a/
Eliminate Federal Funding		
Secondary, urban, and non-Federal-Aid roads and bridges	3.0 b/	0
Transit operating aid	0.9	0.9
Grants for airport development	0.5 b/	0
Intrastate water resource projects	1.5	0-1.5
Reduce Federal Share of Costs		
Reduced federal share on transit capital grants (75 to 60 percent)	0.5-1.5 c/	0.5
Reduced federal share on Interstate Highway reconstruction projects (90 to 25 percent)	0.8	0
Federal loan program for intrastate water resource projects	0 d/	0

SOURCE: Congressional Budget Office.

a. Assumes offsetting federal aid and/or state/local user fees. The exact size of the nonfederal burden would depend on the extent of demand for infrastructure services. Without offsetting federal aid and local user fees, the nonfederal financial burden could increase by as much as federal obligations are reduced, if states chose to continue the same level of commitment.

b. Turnback of existing federal user taxes would eliminate the federal budgetary savings.

c. Federal obligations could be reduced by as much as $1.5 billion if the higher local match resulted in a reduction in the number of projects undertaken.

d. Because of initial capitalization costs, there would be no federal budgetary savings in the early years of such a program. Once the program became self-sustaining, however, federal savings could total as much as $1.5 billion a year, with a corresponding increase in the nonfederal burden.

transit, airports, and water resources. In most cases, a relaxation of federal standards and regulations would logically complement such a turnback of responsibility.

Highways. To concentrate federal highway resources exclusively on the roads of greatest national importance, federal aid for all but the Interstate and Primary systems and related bridge programs could be dropped and full financing responsibility for Secondary and Urban systems transferred to state and local governments. Such a shift in federal and state highway roles could place a substantial burden on state governments, since they would be forced either to see less spent on their highways or to increase taxes. This burden might be eased, however, by reducing the federal tax on motor fuel by 2.7 cents per gallon, thereby permitting the states to raise their taxes by $3.0 billion a year--enough to offset fully the reduction in federal aid (see Table 6). A potential problem, however, is that, as the states increased their own user fees, there is no assurance that the resulting distribution of cost recovery would be uniform among states or applied in such a way that each vehicle class paid its share of highway costs. An alternative would be to keep the federal tax and turn back to the states the appropriate portion of federal fuel tax revenues.

Federal funding of the Interstate Highway System might also be more closely aligned with federal priorities if funds were concentrated exclusively on unbuilt routes that are essential to a national, interconnected system of highways. Routes serving predominantly state or regional needs could be excluded from the Interstate System plan, with the exception of those already under construction and those that have received federal approval of their design. Any such attempt to refocus the Interstate program on national needs would probably affect the states unevenly, given the diversity of approaches that states have taken in building their Interstate routes. 20/

Public Transit. The federal government could eliminate operating assistance to local transit authorities. Public transit operations are essentially of local rather than national interest, involving local decision-making concerning such matters as wages, routes, and levels of service. Moreover, as discussed earlier, indiscriminate operating subsidies are not particularly well suited to reducing congestion or increasing transportation access for the disadvantaged--goals that are frequently cited in justification of such subsidies.

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20. For further details, see Congressional Budget Office, The Interstate Highway System: Issues and Options.

Federal operating assistance grants presently cover about $900 million in operating costs--13 percent of transit operating costs nationwide, and a smaller fraction in large cities. Eliminating this aid would place a significant burden on cities that currently receive federal operating subsidies. This burden could be met in four ways: higher state and local government subsidies, higher fares, reduced service, or improved management. If the difference was made up entirely at the farebox, transit fares, presently averaging 53 cents, would have to rise by about a third. To alleviate hardship, federal operating assistance could be phased out gradually. In addition, since maintenance is considered an operating expense and thus ineligible for capital grant funding, terminating federal operating subsidies could aggravate existing problems of deferred maintenance on many transit systems, unless certain major types of maintenance, such as overhauling an engine, were made eligible for capital grant funding.

The Administration has called for the elimination of federal operating subsidies for mass transit by 1985. Under the Administration's proposal, fiscal year 1984 would be a transition year, with $275 million for operating assistance, down from the 1983 appropriation of $875 million. 21/ However, the proposal to restrict operating assistance to $275 million in 1984 has been rejected by both the House and Senate Appropriations Committees.

Airports. The federal government could eliminate a large part of its direct financial role in airport development. The major commercial airports, in which the principal federal interest is centered, tend to be financially self-sufficient, and have in the past relied on federal aid only to a small degree. Under current policy, federal grants are also made available to a large number of general aviation airports that serve primarily local needs and that appear to have considerable unused revenue-raising potential. If the primary beneficiaries, the users of these airports, do not find it worthwhile to finance further development through user fees, it is unclear why the taxpayers at large should do so. To avoid the risk of regional imbalances in airport development, however, some federal grant assistance could be maintained, and targeted exclusively to large- and medium-sized airports that face difficulties in obtaining nonfederal

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21. The Surface Transportation Assistance Act of 1982 limited the amount of operating assistance available to localities for 1984-1986. For each of these years, urbanized areas with populations greater than 1 million are limited to 80 percent of their 1982 operating assistance apportionment, urbanized areas with 200,000 to 1 million people are restricted to 90 percent of their 1982 apportionment, and urbanized areas with populations of less than 200,000 can use up to 95 percent of their 1982 share.

financing; to small rural airports; and to general aviation reliever airports. Selective federal aid to upgrade the nation's 155 reliever airports might help divert general aviation users from the congested major air carrier facilities, especially if implemented in conjunction with congestion fees such as peak hour surcharges.

Withdrawal of the bulk of federal aid would provide the necessary incentive to airport managers--or states, which often own general aviation airports--to levy appropriate user fees. The possibility of imposing peak hour surcharges, together with other forms of local pricing, would help provide airport authorities with the means to substitute local for federal user fees. On the other hand, there could be considerable practical problems in administering such pricing mechanisms. 22/

Under this option, direct grants to airports might total roughly $300 million a year, or about 30 percent of currently authorized annual federal funding. Elimination of the remaining federal aid would permit about a 20 percent reduction in federal aviation taxes, which presently support airport development and air traffic control services. Alternatively, these revenues could be turned back to the states on a temporary basis, to help ease the transition to fuller nonfederal responsibility for financing airport development.

Water Resources. Under this option, all new intrastate water resources projects would be financed, planned, constructed, and operated at the state or local level. Operation and maintenance of existing intrastate projects could be transferred to the states over a period of ten years. This would shift a considerable financing burden--equivalent to $1.5 billion in 1982 federal spending--to the states (see Table 6), which accordingly would have a strong incentive to implement user fee financing of water resource projects where applicable. As a result of this increased financial responsibility for intrastate projects, states and user groups would be more likely to promote only the most efficient water projects--those that would return benefits in excess of their costs. Less well endowed states could, however, be put at a relative disadvantage compared to states with a stronger fiscal position. Specifically, energy-exporting states and states with a growing industrial and population base could probably expand their financial, technical, and management roles in water resources development much more readily than could states with shrinking populations and industrial bases.

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22. For futher details, see the forthcoming Congressional Budget Office study of airport financing.

Change Funding Provisions to Reduce the Federal Share of Costs

In several areas, including public transit, highways, water resources, and community development, eliminating federal assistance for projects with predominantly local benefits may not be practicable or desirable because localities could not sustain the costs of these programs alone, or because there are significant inequities or hardships involved. In these cases, the currently high federal share of capital costs could be reduced to improve investment decisions and reflect changes in the priority of investment needs.

Public Transit. The high federal matching share for transit capital grants means that, for most urban areas, the availability of federal funds strongly influences local transit priorities. While the Surface Transportation Assistance Act of 1982 reduced the federal share from 80 to 75 percent, a further reduction to 60 percent would double the local share from what it has been, thereby encouraging localities to commit funds only to projects they really need and to make better decisions as to the tradeoff between improved service and reduced fares. In general, localities would be encouraged to serve basic objectives such as cost effectiveness in moving large numbers of people, rather than build capital-intensive projects made attractive by generous federal funding. There are likely to be adjustment problems for some urban areas, however, because of the increased financial burden, which would amount to at least an additional $500 million in local funding for 1984 (see Table 6).

Highways. While federal funding of Interstate System repairs has increased significantly in recent years, a large portion of these funds is eligible for use by states not for repairs but for "reconstruction" projects. These are mostly locally oriented projects that do not entail repair of existing highway capacity, but rather involve construction of routes dropped from the Interstate System plan and special types of new construction, such as added lanes and interchanges, that have considerably lower federal priority than repairing the existing system. Under the existing Interstate 4R program (Resurfacing, Restoration, Rehabilitation, and Reconstruction), states select their own combinations of repair and reconstruction projects, all eligible for 90 percent federal funding. Thus a significant reduction in the federal matching ratio for reconstruction projects--say to 25 or 50 percent--would encourage states to channel more of their 4R funds into repair of existing Interstate routes. A 25 percent federal match would reduce federal obligations, and could increase the states' financial burden, by as much as $800 million in 1984 (see Table 6).

Water Resources. Instead of eliminating the federal role in intrastate water resource projects, a federal loan program could be established that would limit the federal role to that of financing partner for intrastate

projects. This would reduce the federal share of costs while recognizing the federal government's competitive advantage over state and local governments in financing capital-intensive water projects. The fund would require an initial federal investment, but would eventually become self-sustaining as states paid back their loans. States, possibly with local assistance, would select and manage these projects, design and implement user fee systems to recover appropriate project costs, and accept legal responsibility for repaying the costs of providing all vendible benefits as well as an appropriate share of non-vendible benefits. 23/

A possible disadvantage of the program is that high demand for federal loans could deplete the loan fund rapidly, especially early on, before state payments began to replenish the balance. If loan demand was high, distribution of available funds among competing states could pose problems. In addition, defaulting on a loan could prove burdensome and costly for the federal government and the states, possibly resulting in water rights conflicts if the federal government took over a project to recover its investment. 24/

Community Development. Another area in which federal costs could be reduced is the Community Development Block Grant (CDBG) program. Large cities and urban counties are currently entitled to funds regardless of their needs or their ability to finance projects locally, and recipients may use funds to pay the full costs of selected projects.

Federal costs could be reduced by requiring that jurisdictions with local capacity to fund community development projects be required to pay some or all of project costs. Terminating aid to such communities would provide the largest savings, but would also end some services to low- and moderate-income households if jurisdictions chose not to continue current activities. Lowering the share that the federal government pays of projects selected by these communities would probably reduce but not eliminate their activities in this area.

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23. Vendible benefits are those received directly by users, the costs of which can be recovered through some sort of user fee. Non-vendible benefits are benefits to the general public--non-marketable public services that the private market would not otherwise provide, such as maintaining fish and wildlife habitats.

24. For further details, see the forthcoming Congressional Budget Office study of options for more efficient water resources investments.

Change Program Rules by Making Federal Regulations More Flexible

Relaxing federal regulations may make sense in several areas, in order to better match federal programs to local needs. In particular, some changes would make it easier for state and local governments to implement more cost-effective projects. Some federal regulations also could be lifted in areas where federal financing of nonfederal projects is eliminated. Indeed, the benefits from returning responsibility to state and local governments would likely be wasted if the federal rules for spending these funds were not modified as well. For example, federal bridge standards could be waived in the case of bridge programs that are turned back to the states, thereby permitting states to specify their own standards based on local traffic conditions. State highway officials have complained that using federal standards for local bridges can increase construction costs by as much as a third--an expense they incur only because of the 75 percent federal matching share. Modifications could also be made in federal highway standards.

Wastewater Treatment. The Clean Water Act, as interpreted by the Environmental Protection Agency, requires capital expenditures to upgrade wastewater treatment and conveyance facilities with little provision for estimating the benefits of such expenditures. In a number of cases, following the guidelines makes little economic sense because of the specific characteristics of local water quality or hydrological conditions. In some coastal systems, for instance, natural currents can cause mixing, biological degradation, and dilution of wastewater, so that environmental degradation does not result and healthy biological communities thrive in the discharge area. To handle such situations, EPA or the states could issue site-specific coastal waivers allowing less than secondary treatment where justified by local conditions. The savings could be substantial--General Accounting Office estimates are as high as $10 billion in a total of 800 communities. 25/ Wastewater treatment regulations could also be modified where the water is naturally polluted. In rural communities, for example, river water may be so degraded by causes unrelated to wastewater discharges--soil erosion, phosphorus and nitrogen runoff from fertilizers, or chemical contamination from pesticides--that treated wastewater is in fact much cleaner than the natural waterways it empties into.

Public Transit. In other areas, more flexible federal regulations could allow states and localities to assume a larger role in financing their own infrastructure facilities and in developing strategies to best serve local

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25. See U. S. General Accounting Office, "Billions Could Be Saved Through Waivers for Coastal Wastewater Treatment Plants" (May 22, 1981).

needs. In public transit, federal and local regulations governing various aspects of local transit operations could be eased to allow transit operators to take advantage of innovative and potentially more efficient transit alternatives, such as the contracting-out of certain routes and operations to private taxicabs or jitneys (small buses). For example, the cost effectiveness of private taxicabs under contract to transit operators is based on the fact that most taxicab personnel are not unionized. But, under current federal law, unions exert considerable influence and can even restrict the use of federal dollars for these purposes, and transit authorities can be made to pay union-level wage rates in contracting with such companies. 26/ Relaxing these and other regulations would encourage transit operators to implement readily available transit innovations that could reduce costs and better serve the needs of urban and suburban dwellers.

Change Both Funding Provisions and Program Rules by Instituting Block Grants

In several areas, consolidation of existing programs into block grants could reduce federal administrative costs and provide increased flexibility for states and localities to set their own spending priorities.

Highways. The Administration recently proposed a Transportation Block Grant that would consolidate six categorical highway programs and fund them as a unified block grant for 1984-1988 at the funding levels enacted for fiscal year 1984. The six programs are: Urban System, Secondary System, Non-Primary Bridges, Highway Safety (FHWA 402 Grants), Hazard Elimination, and Rail-Highway Crossing. The Administration proposal would increase states' flexibility in spending in these areas, but could pose problems for some by its restriction of funding to 1984 levels. Nevertheless, it could provide a transition from the existing alignment of roles to the states' assumption of full financing responsibility for these six locally oriented highway programs sometime in the future.

Wastewater Treatment. Block grants could also be applied to wastewater treatment. The federal government could consolidate the existing 500 to 700 project grants made annually under the EPA program into block grants for each state. 27/ Although some of the cost of disbursing and auditing project funds would be shifted to the states, this consolidation

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26. Section 13(c) of the Urban Mass Transportation Act of 1964.

27. The Administration included EPA wastewater grants in a very different block grant proposal that is part of its 1983 Federalism

would significantly reduce federal administrative costs, and would also allow the states greater discretion in spending their allotted funds. It also might encourage the use of state infrastructure banks, as discussed later.

Community Development. Another strategy for program consolidation, included by the Administration in its 1984 budget submission, would be to combine the CDBG program and the General Revenue Sharing (GRS) program--which provides unrestricted aid to localities--into a single unrestricted block grant for local governments. Because jurisdictions currently entitled to CDBG funds would be assured that their funding levels would not be reduced under this plan, the proposal would have the effect of converting CDBG into an unrestricted grant. The merits of this consolidation would depend on the value that the Congress placed on community development projects relative to other state and local activities. Since CDBG recipients can currently use funds for a wide range of development activities, lifting restrictions on CDBG would probably lead to some increased spending for non-community development activities, rather than to additional spending for community development needs.

Encourage Cross-Cutting Financing Mechanisms

To help states and localities assume a larger share of the responsibility for financing public works programs, the federal government could encourage the creation of state infrastructure banks and other cross-cutting financing mechanisms. The state of New Jersey is currently moving ahead with a state infrastructure bank proposal, and recently introduced federal legislation would authorize substantial new federal funds to capitalize state infrastructure banks and other comparable financing mechanisms. An alternative source of funding would be from federal programs that are candidates to be turned back to the states. This might be an effective way to integrate federal financial help with increased state and local responsibilities. Another possibility would be to establish a federal infrastructure bank instead of individual state banks. 28/

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27. (Continued)
Initiative--a State "Mega-block" Grant that would consolidate more than 20 existing categorical and block grants, mainly supporting a variety of human service programs.

28. Bills introduced in this session of the Congress that would authorize new federal funds for state or federal infrastructure banks or comparable financing mechanisms include S. 532, S. 1330, S. 1619, H.R. 1480, and H.R. 2419.

State infrastructure banks would function essentially as revolving loan funds for public works projects. They could be capitalized with both federal and state appropriations as well as proceeds of state bond issues, user fees, and other state revenues, private capital, and the banks' own earnings on equity capital. The banks would serve as the states' vehicles for issuing revenue-backed infrastructure bonds, and a portion of their capital could also help enhance the creditworthiness of localities that might otherwise have more limited access to public credit markets.

In New Jersey, for example, federal capital grants would be combined with state bond proceeds to make low or no-interest loans to municipalities through the new state infrastructure bank. Under this plan, the state of New Jersey estimates that some 200 wastewater systems could be upgraded, instead of 11 if funded directly by EPA project grants. While one result of this could be that the municipalities receiving loans would pay substantially higher user fees than they would under direct project grants from the EPA, the likelihood of higher fees should encourage localities to choose the most cost-effective solutions to their wastewater treatment needs.

Federal encouragement of such state financing mechanisms could take the form of initial capitalization, technical assistance, and legislation to permit federal grant monies (such as EPA Construction Grants for Wastewater Treatment) to be used for loan purposes.

CHAPTER V. EDUCATION, EMPLOYMENT, AND SOCIAL SERVICE PROGRAMS

The federal role in education, employment, and social services grew substantially during the 1960s and early 1970s, with an increased emphasis on activities targeted to groups with special needs. Many new programs were introduced during this period, and existing programs were modified with the intent of inducing nonfederal governments to direct more resources toward meeting the needs of disadvantaged groups in their communities.

While this federal effort was often successful, it was not without its problems. Some programs were criticized as misdirected, duplicative, or unnecessary. Although recent legislation has responded to critics in some areas--for example, changes in employment programs authorized by the Job Training Partnership Act, and elimination or consolidation of numerous small education programs under the Education Consolidation and Improvement Act--it appears that there are still other modifications that might promote more effective federal spending.

This chapter has three major sections. The first outlines the basis for federal involvement in these human services. The second briefly describes the current federal programs and their effects. 1/ The third section summarizes problems and discusses options the Congress might consider to modify the federal role in these areas.

BASIS FOR FEDERAL INVOLVEMENT

The primary rationale for current human service programs is concern for the distribution of resources--a desire to relieve hardship and inequity--although some activities may have spillover benefits as well, and a few activities can only be justified on the basis of spillovers. One activity--the Employment Service--is based in part on the advantages of centralized coordination.

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1. A more detailed description of current programs is contained in Appendix B.

Distribution of Resources

Current activities whose primary purpose is to relieve hardship or inequity may be identified with more specific goals. These include a desire to provide more equal opportunities to disadvantaged groups, including the poor and the handicapped; to defray the costs of federally mandated activities; to compensate localities for the effects of federal activities that impose costs on them unevenly; or to ensure that caretaker services are available to dependent persons.

Programs that address the goal of providing more equal opportunities for advancement are those that target educational or employment services on disadvantaged groups. They include compensatory, special, and bilingual education programs, as well as employment assistance programs. Special and bilingual education programs help to defray the costs of ensuring the educational rights of handicapped and non-English-speaking children, in addition to enhancing their opportunities.

Impact aid is a program wholly intended to compensate localities for the effect of federal installations that reduce local tax bases. Some other programs might also be justified, in part, on this basis. One example is bilingual education, since the influx of non-English-speaking immigrants is controlled by federal immigration policy and the preferences of immigrants, both of which are beyond the control of affected communities. Employment assistance programs are another example, since federal macroeconomic and trade policies can have very uneven regional effects on employment.

Programs providing caretaker services include child welfare programs and community- and home-based services for elderly and disabled persons. These exist partly for humanitarian reasons, but in some instances they may also serve to reduce federal and state welfare costs by enabling certain elderly and disabled persons to do without institutional care.

Spillovers or External Effects

When state or local activities have external benefits that spill over to other parts of the nation, federal support for those activities may be appropriate in order to induce expansion. Federal support for both education and employment programs might in part be justified on this basis, because of the national advantages of a literate and trained population.

Spillover benefits also arise from state and local activities that help to make people more self-sufficient and thereby reduce welfare costs. Spillovers occur because the federal government reimburses states for more

than half of their welfare costs, on average, so that taxpayers throughout the nation benefit from welfare savings in any state. Two major groups of programs may, as already noted, help to reduce welfare costs: those that target educational or employment services on disadvantaged persons; and those that provide caretaker and other social services to dependent persons.

Centralized Coordination

Centralized coordination of information about job openings and persons available for work can improve the efficiency of the labor market by facilitating labor exchange. Employment Service offices in each state maintain statewide lists of available jobs and applicants. In addition, states have access to a list of job orders nationwide through an interstate clearance system.

THE CURRENT FEDERAL ROLE

In 1983, the federal government authorized $28.1 billion for education, employment, and social services (see Table 7). 2/ Of this, 62 percent funded grants to state and local governments for the provision of services. This chapter focuses primarily on grant programs since there is little controversy over the federal role in its direct activities. 3/

The federal role in state and local activities is significant, even though the federal government is rarely involved in the direct provision of these services. Both the availability of federal funding--through more than 100 grant programs--and the accompanying program regulations influence state and local activities. Financially, the federal role is least significant for education, where federal dollars make up less than 10 percent of all public spending for elementary, secondary, and vocational education (see Table 8). But federal dollars provide nearly 100 percent of public support for employment assistance programs, and about 60 percent of public support for social services. The largest grants are distributed by formula with no requirement for cost sharing by recipient governments. The cost-sharing

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2. Additional federal support occurs through tax expenditures and loans or loan guarantees.

3. Direct (non-grant) federal spending in 1983 provided educational services for Indians and migrants ($0.3 billion), financial aid to individuals and institutions for postsecondary education ($7.3 billion), support for research and cultural activities ($1.0 billion), and national job training programs for selected disadvantaged groups ($0.9).

TABLE 7. FEDERAL FUNDING FOR EDUCATION, EMPLOYMENT, AND SOCIAL SERVICE PROGRAMS (In billions of dollars of budget authority)

	Total Federal Funding		Grants to State and Local Governments	
	1982	1983	1982	1983
Education and Related Programs:	14.8	15.4	6.3	6.8
Elementary, secondary, and vocational education	(6.4)	(6.8)	(6.0)	(6.4)
Postsecondary education	(7.4)	(7.4)	(0.1)	(0.1)
Research and general education aids	(1.0)	(1.3)	(0.3)	(0.3)
Employment Programs	5.0	6.2	3.4	4.4
Social Service Programs	6.1	6.6	5.8	6.3
Total a/	25.9	28.1	15.6	17.5

SOURCE: Congressional Budget Office.

a. This does not include tax expenditures ($14.8 billion in 1982) or new federal loans ($1.2 billion) and loan guarantees ($6.2 billion). Tax expenditures occur in all of the above areas, while federal loans and loan guarantees are generally for postsecondary education.

requirements under other formula grants are often irrelevant, since recipient governments typically spend more than is required under grants that subsidize traditional state and local activities. But cost-sharing requirements under formula grants that support nontraditional activities, and for project grants, may be useful in promoting efficient practices.

TABLE 8. SUMMARY DESCRIPTION OF FEDERAL GRANT PROGRAMS FOR EDUCATION, EMPLOYMENT, AND SOCIAL SERVICES

Program Area	Description of Programs Funded	Distribution Mechanisms	Matching Requirements	Federal Share of all Public Spending
Education	Special services for students disadvantaged by poverty, handicaps, or limited English-speaking ability. Also support for general education programs, and libraries	Mostly formula grants based on the population eligible for services. Bilingual programs supported by project grants	No recipient match required for most programs. Fifty percent match required for some general vocational programs	About 10 percent overall, although the share is much higher for programs targeted on the economically disadvantaged
Employment	Training programs for disadvantaged and dislocated workers. Also the Employment Service	Mostly formula grants based on unemployment and sometimes the relative number of economically disadvantaged persons or labor force size	No recipient match required for largest programs. Recipient cost-sharing (10 percent or variable) required for smaller programs	Close to 100 percent
Social Services	Child welfare; nutrition and homemaker services for the elderly and disabled; vocational rehabilitation; counseling and advocacy; family planning	Mostly formula grants based on population and sometimes income	No recipient match required for largest programs. Recipient cost-sharing (typically 15 to 25 percent) required for some smaller programs	About 60 percent overall, although the share varies by type of service

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Education and Related Programs

In 1983, the federal government spent $15.4 billion for education, educational aids, or cultural activities. Nearly half of this provided financial aid to students for postsecondary education through student loans, grants, and college work-study programs. The goal of federal student aid is to improve access to higher education for low- and middle-income individuals who might not otherwise attend college, based on concerns for equity and productivity. The federal role in postsecondary education poses no significant problems in intergovernmental relations since most aid is provided directly to students. 4/ Consequently, it is not discussed in this chapter.

Most of the remaining federal funding--$6.8 billion out of $8.6 billion--was distributed through grants to state and local governments. 5/ Ninety-five percent of these grant funds supported elementary, secondary, and vocational education, while the remaining 5 percent was used primarily to improve library services and to support the Corporation for Public Broadcasting. More than 70 percent of federal grant dollars for elementary, secondary, and vocational education funded programs for students with special needs--compensatory education for low-income underachieving students, special education for handicapped students, and bilingual education for students with limited proficiency in English. The remaining 30 percent subsidized general education and vocational education programs.

With the exception of bilingual programs, virtually all grants for elementary, secondary, and vocational education are allocated by formula, generally on the basis of the relative number of students eligible for services. Funds for bilingual programs are allocated on a project basis and are intended as short-term capacity-building grants rather than as continuing subsidies.

Rules have generally been quite restrictive in programs that serve students with special needs, but this may be changing. In 1981, Chapter I of

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4. There are complaints, though, about possible denial of aid to persons enrolled in colleges or universities that are not in compliance with federal antidiscrimination laws.

5. Funds not distributed as intergovernmental grants were used to support Indian and migrant education, research, and cultural activities (including the National Endowments for the Arts and Humanities, the Smithsonian Institution, the National Gallery of Art, and the Institute of Museum Services).

the Education Consolidation and Improvement Act (ECIA) altered provisions of the antecedent Title I program for compensatory education to provide greater flexibility to local agencies in the selection of schools and students participating in the program. Further, the Administration has proposed amending the Bilingual Education Act to allow greater local discretion in how the needs of non-English-speaking students are to be met. Some relaxation of the regulations governing education programs for handicapped children was proposed, but later withdrawn. Finally, the Administration proposed consolidating various programs for vocational and adult education, which would eliminate federal vocational programs targeted specifically on the disadvantaged.

Effects of Current Programs. Federal grant programs for students with special needs have had considerable influence on certain aspects of education at the local level. Federal dollars are the primary source of funding for compensatory services for the disadvantaged. It is likely that such services would be substantially reduced or eliminated in the absence of federal funding, although compensatory programs--at least at the pre-school and elementary school levels--have been successful in improving the performance of disadvantaged children relative to other children. 6/ In contrast, services for handicapped students and students with limited proficiency in English would continue without current federal programs, because federal courts have ruled that special services for these students

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6. Both federal funding and restrictions on the use of funds appear to be important to the continuation of compensatory education programs targeted on disadvantaged groups. In most states there were no school programs for the disadvantaged prior to federal involvement, and evidence from the Title I District Practices Study indicates that schools faced with cuts in federal spending for Title I generally cut back the number of students served in direct proportion. There are also preliminary indications, based on the expressed intentions of school officials, that relaxation of the targeting requirements for compensatory programs--such as occurred with passage of the ECIA in 1981--will result in a reduction or dilution of services to current program participants in favor of more general educational services. See Richard Apling, The Influence of Title I Budget Cuts on Local Allocation Decisions: Some Patterns from Past and Current Practices, and Michael J. Gaffney and Daniel M. Schember, Current Title I School and Student Selection Procedures and Implications for Implementing Chapter I, ECIA, both from Advanced Technology (September 1982).

are required by law. 7/ Although federal programs pay only a fraction of the cost of these special services, they have nevertheless affected the kinds of services that are provided. In the absence of federal programs and associated regulations, the services required might be less well defined.

Federal grant programs that support general education or educational aids include impact aid, untargeted programs under the Vocational Education Act (VEA), the state block grant under Chapter II of the ECIA, and subsidies to libraries. Impact aid has a clear rationale as compensation to school districts that are adversely affected by federal installations, although the payments are typically too low to compensate them fully, as determined either by their school expenditures for federally connected children or reduced property tax collections. 8/

Federal support for other general education programs might be justified on the basis of the general benefits of a literate and trained population, but this argument depends on spillover benefits from additional services induced by federal support. Federal dollars provide about 10 percent of all public spending for vocational education; although services may increase by up to this amount, it is more likely that some proportion of federal support is used to replace state and local funding that would otherwise be provided. Moreover, spillover benefits from any induced increase in vocational education are unlikely in any event, because there is no apparent long-term advantage to be derived by vocational education students relative to general curriculum students--at least at the secondary level, which receives 80 percent of federal funds. Spillover benefits from Chapter II of the ECIA are negligible too, since this grant--which is essentially equivalent to unrestricted aid to education--represents less than 0.5 percent of all spending for elementary and secondary education. Spillovers are also probably small from federal support for libraries, which is less than 5 percent of all public spending for this purpose.

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7. Strictly, state and local education agencies that accept federal dollars for any purpose must provide special services to facilitate access to mainstream public education for handicapped and non-English-speaking students.

8. Although federal installations may generate other kinds of revenue--from sales and income taxes, for example--these will more likely accrue to state governments than to the affected localities. In addition, if federal installations were not there, many sites would be put to some other use that could also generate sales and income tax revenues, as well as property taxes.

Employment Programs

In 1983, the federal government spent $6.2 billion for employment programs. About 74 percent of this--$4.6 billion--supported training and other employment services for disadvantaged and dislocated workers, partly through grants to state or local agencies ($3.7 billion) and partly through federally administered programs ($0.9 billion). 9/ About 13 percent of federal spending provided grants to states for the Employment Service, and the remainder was for federal administrative expenses. 10/

Most federal funding for training is now authorized under the Job Training Partnership Act (JTPA), which will be fully implemented by October 1983, replacing the Comprehensive Employment and Training Act (CETA). Under the JTPA, programs for disadvantaged workers are 100 percent federally funded, with grant funds allocated among the states by formula based on the relative number of unemployed and low-income persons. Funds for dislocated worker programs are allocated some on a project basis and some by formula based on unemployment; a state match that varies from 0 to 50 percent is required, depending on the state's unemployment rate.

Welfare recipients, who are among those eligible for services under JTPA programs for the disadvantaged, can obtain similar services through the Work Incentive (WIN) program. In addition to training and other employment services, however, participants in WIN are provided with a variety of supportive services--such as child care--that are limited under JTPA. Registration for WIN or an alternative work-welfare program is mandatory for certain family members receiving Aid to Families with Dependent Children, although about half of those who register for WIN are unassigned--that is, receive no services--because of insufficient funding.

The Employment Service is a federal activity--with 100 percent federal funding and control--that is administered by the states. Federal funds are allocated among the states by formula, based on labor force size and the number unemployed. Labor exchange services are provided free of charge both to job applicants and to prospective employers. In addition, the Employment Service has a number of supplementary responsibilities includ-

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9. The federal government administers the Job Corps as well as special programs for migrants and Indians.

10. Administrative expenses include the costs of enforcing minimum wage and child labor laws, as well as laws governing management and union practices.

ing recruiting for federal training programs and certifying eligibility for certain other federal programs.

Effects of Current Programs. Although there is as yet no experience under the JTPA, evidence from previous programs under CETA and WIN indicates that training and other employment services can be effective at improving the employment prospects of disadvantaged workers and increasing their future earnings. Low-cost intensive job search programs have been shown to increase employment rates substantially for new entrants or reentrants to the labor market who have adequate work skills. For those for whom job search assistance is not enough, the results of various more costly alternatives vary. Disadvantaged youth apparently require intensive programs combining remedial education, training, and work experience. Women entering the labor force for the first time, or reentering after a number of years, benefit equally from work experience, classroom instruction, or on-the-job training. None of these approaches appears to enhance the employability or wage rates of men with a history of low-wage or unstable employment, although more intensive remedial programs--which have not been available for adults--might be more successful. Some programs for the disadvantaged--especially for women in WIN--appear to be cost-effective, in that future savings in federal welfare costs due to increased earnings by participants exceed federal program costs. 11/

For dislocated workers, evidence from pilot projects offering reemployment services to workers in Michigan indicates that program participants were reemployed faster, and at higher wage rates, than similar workers who did not receive services. Further, it appears that training plus job search assistance had no greater impact on reemployment than intensive job search alone, so that programs for dislocated workers might be very cost-effective by emphasizing low-cost job search assistance.

The Employment Service is an important placement resource for disadvantaged workers. Youth, women, minorities, the physically handicapped, and other disadvantaged groups are all served in numbers disproportionate to their representation in the labor force. This is partly the result of a deliberate emphasis begun during the 1960s, but it is also the result of a natural selection process in that workers with more experience and specialized work skills often have good job search alternatives--through personal contacts, labor organizations, and professional associations. Complaints have been made that the various ancillary responsibilities given to the Employment Service have reduced the resources available for its basic labor exchange functions--counseling and placement services. The adverse

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11. Congressional Budget Office estimates.

effects of this conflict between its labor exchange and supplementary responsibilities may be lessened, however, by provisions contained in the JTPA, which establish separate funding for the two kinds of activities.

Social Service Programs

Federal funding for social services in 1983 was $6.6 billion. About 95 percent of this--or $6.3 billion--funded grants to state and local governments, with more than 40 percent channeled through the Social Services Block Grant (SSBG). This grant supports a broad set of services, including day care for children and dependent adults, homemaker and other in-home services, and child welfare services. Other more restrictive categorical programs support Head Start (a compensatory program for pre-school children), community services, child welfare services, social and nutrition programs for the elderly, rehabilitation programs for the disabled, services for individuals with developmental disabilities, and volunteer activities in low-income areas. Most of these grants are allocated by formulas based on population, or some subset of population, and sometimes state per capita income.

Effects of Current Programs. Federal social service programs have sometimes induced new activities by nonfederal governments that subsequently continued to grow independently of federal support--for example, public child welfare services initiated by the Social Security Act of 1935, and services for the elderly initiated by the Older Americans Act of 1965. Currently, however, most federal spending for social service programs is very close to revenue sharing earmarked for social services. Although funding is provided through a number of separate categorical programs, recipient governments have substantial flexibility in allocating the total dollars available to them for social services. This is because spending by state and local governments is so much in excess of what is required under most current grants, and because such a large proportion of federal aid is through the very loosely targeted Social Services Block Grant.

Federal matching requirements are generally binding only for Head Start, vocational rehabilitation services, and perhaps for developmental disabilities programs. These services might be reduced substantially in the absence of earmarked federal funding, despite the evidence that Head Start and vocational rehabilitation programs are successful. Head Start provides social, educational, and health services to disadvantaged pre-school children. It is generally effective at increasing the cognitive skills, social development, and health of participants, enabling them to begin their regular school careers on a more equal footing with other children. According to estimates by the Rehabilitation Services Administration,

vocational rehabilitation services create savings for both federal and state governments because the future earnings of rehabilitated persons generate enough tax collections and reduce public assistance sufficiently to more than cover program costs.

OPTIONS FOR CHANGE

Federal support for education, employment, and social service programs has dropped in the last few years, and the Administration has proposed that many of these programs be terminated or "turned back" to the states. Whether or not it is important to continue a federal role in these human service programs, and what dimensions and forms that role should take, are value-laden questions whose resolution can ultimately be determined only by the Congress. The purpose of this section is to outline the advantages and disadvantages of modifying some current programs, either by eliminating federal program responsibility, changing the funding provisions, or changing the program rules. The options discussed here are illustrative, and include only a sampling of the modifications that might be made.

Programs that do not effectively address concerns about the distribution of resources, and for which there are no significant external effects and no need for centralized coordination, are candidates for termination. Other options discussed here include changing the funding allocation process to address local needs more effectively, modifying cost-sharing provisions that may be inappropriate, consolidating related programs when that would not defeat Congressional intent, and altering program rules to provide the greatest possible flexibility to recipient governments without sacrificing Congressional goals.

Eliminate Federal Support

This approach is most frequently suggested in connection with general education programs, but may be applicable to some employment programs and to social services as well.

Education Programs. Federal aid for general education--through Chapter II of the ECIA and basic vocational programs under the VEA--has no strong rationale, since these programs do not target resources very effectively on special needs nor are they likely to generate significant external benefits. Termination of Chapter II of the ECIA would have little impact on most school districts since the grant is such a small proportion of total school expenditures, although the impact would be relatively greater in

school districts with large numbers of high-cost students with special needs--since this factor is considered in addition to the total number of students for allocation of grant funds within (but not among) states.

Termination of federal funding for basic vocational education programs could be a little more disruptive, since it amounts to nearly 10 percent of total public spending for vocational education. Further, school districts with relatively high concentrations of disadvantaged and handicapped students might be affected more adversely than other school districts, because the requirement that 30 percent of funds for basic programs be targeted on disadvantaged or handicapped students tends to result in somewhat higher VEA expenditures in districts with high concentrations of disadvantaged and handicapped students. 12/ An alternative to eliminating VEA programs would be to target all funds, as discussed later.

Federal support for library services has also been criticized. Both past and present Administrations have sought to eliminate federal support for library services by arguing that this is a low-priority item for scarce federal dollars, since there is little indication that the public (as distinct from the providers of the services) perceives any serious inadequacy in the availability of library services.

Employment Programs. The federal role is dominant in the funding of public training and employment programs, and is probably necessary to their continuation in most geographic areas. Reduction or termination of federal support for training, especially for disadvantaged workers, would weaken the federal commitment to improving equality of opportunity and might increase welfare costs as well. Since federal programs have just been substantially modified by the Job Training Partnership Act in an attempt to improve the effectiveness both of public training programs and of the Employment Service, it would probably be counterproductive to suggest revisions at this time. It is generally believed that one of the major problems with CETA--the predecessor of JTPA--was that requirements under the act were modified so frequently that programs never had an opportunity to become effective.

One change proposed by the Administration, however, is elimination of the separately authorized WIN program and its replacement with a mandatory workfare program for employable welfare recipients. 13/ While WIN

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12. National Institute of Education, The Vocational Education Study: The Final Report (September 1981), p. III-34.

13. Workfare programs are optional in states now, either as replacements for or in addition to WIN. The federal government reimburses states

provides job search assistance, training, and work experience, workfare would provide only work experience, by requiring that unemployed recipients work off the value of their welfare benefits in public service agencies. Since evidence from WIN programs indicates that work experience is as effective at improving employability as more costly training programs for women without severe disadvantages, workfare might not only provide public service benefits to the community but also improve some participants' prospects of finding paid employment. 14/ Women who are less job-ready, however, require training or remedial education to improve their employment prospects, and may have such poor job skills that there would be no public benefit from placing them in workfare. Further, even women who are job-ready could benefit from job search assistance to help them find paid employment. These employment services would still be available to welfare recipients under the JTPA if WIN was eliminated, and employment-related support services currently available through WIN could be provided through the SSBG. It would probably be more difficult, however, to obtain a well-coordinated package of services through these separate programs than through WIN.

Social Service Programs. Federal support is not essential to the continuation of most social services, but it is nevertheless important to state and local governments because it is a large proportion of aggregate public funding for them. In the absence of federal funding, overall service levels would decline and some services--Head Start, for example--might not be provided at all. There is evidence that nonfederal governments are more likely to step in to cushion federal funding losses for social services than for some other human service programs--such as education or training for the disadvantaged--but full replacement would be unlikely. 15/ If so, the needs of disadvantaged groups would be addressed less adequately, and welfare costs might increase as well.

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13. (Continued)
for expenses under workfare programs on the same basis as for AFDC expenses. See Appendix C.

14. Severe disadvantages include the lack of a high school degree, poor health, and poor English, among others. In evaluation studies of WIN programs, the sample size for men is too small to yield reliable results.

15. John L. Palmer and Isabel V. Sawhill, ed, The Reagan Experiment (The Urban Institute, 1982), p. 179. Also, Richard P. Nathan and Fred C. Doolittle, The Consequences of Cuts: The Effects of the Reagan Domestic Program on State and Local Governments (Princeton Urban and Regional Research Center, 1983).

Some separately funded programs might be eliminated by consolidation with the comprehensive Social Services Block Grant, however, without much consequence except to simplify administration for both federal and recipient governments. Candidates for elimination through consolidation might include the Community Services Block Grant, some child welfare programs, and programs for the elderly. The advantages and disadvantages of this approach are discussed in a later option.

Change Funding Provisions by Using a Full Cost Formula

In some education programs, it might be appropriate for the federal government to assume the full costs that are imposed on local school districts because of federal laws, regulations, or installations. This would better address local needs, but would also increase federal spending substantially.

Special Education. Contradictory views exist about federal funding for special education. Some argue that the federal government should fund all the extra costs of educating handicapped children, since special services are required as the result of federal law. Others contend that the federal government has no special responsibility in this area, since public education is a basic right for which state and local governments are responsible and since no activity of the federal government affects the incidence of handicaps in the local school population. Acceptance of the first view would increase federal spending in 1984 tenfold, to perhaps $12 or $13 billion, while acceptance of the second view would lead to elimination of federal programs for education of the handicapped thereby reducing federal spending by about $1.3 billion. An alternative that need not involve any change in overall federal spending would be to revise the formula used to allocate grant dollars to include a measure of fiscal capacity as well as the number of handicapped students, so that federal funds would be concentrated where assistance was most needed. The use of fiscal capacity as a factor in allocation formulas is discussed in the following option.

Bilingual Education. Federal funds for bilingual education could be allocated by a formula based on the number of school children with limited proficiency in English and the average additional costs of serving such children. Full federal funding for bilingual education would be a way of distributing the costs of national immigration policy across the nation as a whole, rather than concentrating them on the localities where immigrants choose to settle. It could also enhance the opportunities and potential productivity of the students served. Currently, federal funds for bilingual education are allocated on a project basis and serve only 10 to 20 percent of

all school children who require services. 16/ Full federal funding would increase federal spending for bilingual education by five to ten times the current level, however, to as much as $1.5 billion in 1984. Further, it would represent a redirection in purpose for federal bilingual programs, from capacity-building to continuing support.

Impact Aid. The current impact aid program (and other aid programs to federally affected localities) could be replaced by a uniform system of payments in lieu of taxes (PILOT) based on full tax equivalency. Currently, payments to compensate localities that are adversely affected by federal installations are based on a variety of ad hoc criteria, rarely related to the value of property removed from the local tax base because of federal ownership. The result is a system of sometimes overlapping payments to federally affected localities that is not consistently related to, and is generally far below, the lost property tax revenues. A PILOT program would improve tax equity, in that all local "residents" (including the federal government) would be treated equally; it would discourage the wasteful use of property by the federal government; and it would eliminate a subsidy--with uneven incidence--of the federal sector by the (mostly) local sector. 17/ These benefits would not be costless, however. Estimates for 1978 indicate that the gross property tax liability of the federal government on its non-open-use land would have been about $3.7 billion, and that payments in that year under current compensation programs were approximately $1.0 billion. 18/ Hence, the cost of replacing current programs with PILOT in 1978 might have been as high as $2.7 billion, although this is probably an overestimate for 1978 because local tax rates in affected areas would presumably have fallen in consequence of the expanded tax base. 19/

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16. Congressional Research Service, "Impact of Budget Changes on Major Education Programs, Both Enacted and Proposed, During the 97th Congress," February 25, 1982, p. 15.

17. Advisory Commission on Intergovernmental Relations, Payments in Lieu of Taxes on Federal Real Property: In Brief (October 1981), p. 29.

18. Federal installations on non-open-space areas appear to require the same level of local services as private enterprises would on average. A nationwide payment system for federal open-space areas is already in effect and is not subject to the same criticisms as are being given here.

19. Advisory Commission on Intergovernmental Relations, Payments in Lieu of Taxes, p. 15.

It is uncertain whether the cost in 1984 would be higher or lower than the estimate given for 1978, since federal property holdings, property values, and tax rates have all changed.

An alternative that would not require additional federal spending at this time would be to redistribute current payments to federally affected localities in proportion to what PILOT payments based on full tax equivalency would have been. At current funding levels, PILOT payments might cover only 25 percent of the implicit federal tax liability, but the proportion paid might be increased in future years as federal revenues increased. This change in the allocation of current payment levels could be temporarily disruptive for localities that would receive less aid, however. In addition, once payments were linked clearly to federal property values there would likely be pressure from affected localities to move rapidly to 100 percent funding, thereby hampering attempts to reduce the size of future federal deficits.

Change Funding Provisions by Including Fiscal Capacity in the Allocation Formula

Allocation formulas for service grants all use measures of service need, but some education and social service grants use per capita income--as a measure of fiscal capacity--to modify need factors so that areas with low fiscal capacity receive more per need unit than richer areas. 20/ There are both advantages and disadvantages to the continuation or expansion of this practice.

Using fiscal capacity as a formula factor can help to ensure that federal subsidies for designated state or local services are concentrated in areas least able to support them from their own revenues, thereby addressing hardship and spillovers more effectively than if funds were more uniformly distributed. In addition, since general revenue sharing payments are currently made only to local governments, the use of fiscal capacity in the allocation of service grants to states is an alternative way to achieve some fiscal equalization among state governments.

On the other hand, the accumulation of a number of service grants allocated in part on the basis of fiscal capacity could have arbitrary and

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20. Current human service programs that use per capita income to modify need factors in their allocation formulas include vocational education, child welfare services, rehabilitation services, and developmental disabilities programs.

unintended distributional effects in the aggregate, unless the various grants were carefully coordinated. For one thing, some nonfederal governments could receive more federal funding overall than full equalization would require. For another, the commonly used criterion of per capita income is a poor indicator of fiscal capacity because income is only one of several important tax bases used by nonfederal governments. More comprehensive measures--such as the Representative Tax System discussed in Chapter VII--could measure fiscal capacity more accurately, but would also be more difficult to construct, especially for local governments.

An alternative way in which to achieve better targeting in the allocation of service grants might be to use more narrowly defined measures of service need. The measures used in current grants are sometimes very broad--general population for social services, or age-weighted population for vocational education, for example. More restrictive needs measures based on groups that would likely require more, or more costly, services than the average population might be used instead. In particular, the low-income or elderly population, or a weighted combination of the two, might be used to allocate social service grants. 21/ The distribution of vocational education funds might be based on age-weighted counts of low-income, handicapped, and non-English-speaking populations. Agreement on the appropriate weight to give various high-cost population groups in the needs measure might be difficult to achieve, however.

Change Funding Provisions by Altering Cost-Sharing Requirements

Cost-sharing requirements can be used to induce a higher level of spending by state or local governments from their own sources than they would otherwise choose. Cost-sharing might also promote more efficient use of federal funds in grant programs supporting services not usually provided by recipient governments, since recipient governments would have more incentive to monitor program activities if some of their own resources were involved. In activities funded on a project basis--such as Head Start--cost-sharing requirements may also help to eliminate less committed applicants.

In current education and social service programs, however, there are instances in which cost-sharing requirements may be serving no useful purpose, while in some employment programs higher cost-sharing by recip-

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21. Elderly population is the needs measure currently used in grants under the Older Americans Act. The allocation of employment assistance grants is also already based on narrowly defined needs measures.

ient governments might be appropriate based on measurable local benefits resulting from program activities.

Education and Social Service Programs. Current cost-sharing requirements could be eliminated in formula grant programs where recipient governments generally spend more than their required match, including grants for adult education, vocational education, child welfare services under Title IV-B of the Social Security Act, and services for the elderly under the Older Americans Act. Although the matching requirements in these programs may once have been effective in inducing greater nonfederal support for these activities, now most states voluntarily choose to spend more than is required. Eliminating the matching requirements would simplify program administration somewhat, with no other effect in most states. In a few states, however, the matching requirements may be binding for some programs, so that their elimination would reduce own-source spending for activities under those programs. For example, some states might set aside less for supplementary services to disadvantaged and handicapped students in basic vocational education programs in the absence of current matching requirements. 22/

Employment Programs. Cost-sharing requirements in WIN--currently 10 percent--could be increased to equal the (variable) state share of AFDC payments. Under this option, states would share in WIN program costs to the same extent they share in the primary measurable benefit from WIN, which is the reduction in welfare costs due to the increased earnings of participants. More registrants could be served under WIN, without additional federal spending. Further, states would pay the same share of costs for WIN as they do for the optional workfare programs they may provide as an alternative. As a result, decisions about which program to assign registrants to could be based on which set of services would be most effective for each registrant, with no distortion arising from the different cost-sharing requirements under the two alternatives, at least up to the limit of funding provided for WIN. 23/ This would impose additional costs on states, however.

Cost-sharing requirements in other training programs for the disadvantaged--under the JTPA--might also be imposed. This could increase

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22. U.S. Department of Education, Annual Evaluation Report, Volume II, Fiscal Year 1981, p. 313.

23. Federal funding for WIN is limited to the amount appropriated, while federal funding for workfare programs is open-ended reimbursement for a portion of virtually all expenses.

total funding for training the disadvantaged, and induce recipient governments to use federal training funds more efficiently. To reflect the extent of benefits that accrue locally, primarily through reductions in public assistance payments and increased tax collections, the cost-sharing requirement could be variable. It would be difficult to get a reasonable measure for benefits that accrue locally, however, since--unlike the WIN program--not all JTPA participants would be AFDC recipients. A large proportion of participants would be youth, for whom immediate program benefits might take the form of improved school performance rather than increased earnings that would reduce welfare costs. If the share was set higher than perceived local benefits, however, federal grants would not be accepted and there might be no training programs provided for the disadvantaged.

Change Program Rules

The flexibility allowed grant recipients in some education programs might be reduced for some programs--compensatory education, for example --and increased for others, such as bilingual programs, in order to ensure that federal funds are used effectively.

Compensatory Education. The requirements for targeting funds for compensatory education under Chapter I of the ECIA might be tightened, perhaps reinstituting the requirements of the antecedent Title I legislation. Preliminary indications are that the more relaxed targeting requirements of Chapter I will result in a reduction or dilution of services to current program participants in favor of more general educational services, thereby probably reducing the efficacy of compensatory education programs. On the other hand, it may be better to wait for clearer evidence that compensatory services have been adversely affected by revisions under the ECIA, since frequent revisions are disruptive and can, in themselves, threaten program effectiveness.

Bilingual Education. Allowable activities under federal bilingual programs could be expanded to include alternatives to bilingual education, as proposed by the Administration. Currently, federal funding under the Bilingual Education Act is provided only for bilingual programs--where some instruction must be in the students' native language--and not for English-only alternatives. Civil rights enforcement has also emphasized bilingual education as the only acceptable way in which to guarantee the educational rights of non-English-speaking students. There is no evidence, however, that bilingual education is always superior to certain alternatives. Further, bilingual education is impractical in schools where instruction in many foreign languages would have to be provided. Allowing local educational agencies greater discretion in how they choose to address the needs of their non-

English-speaking students might enable them to serve these students more effectively, although some schools might take advantage of this flexibility to provide less adequate services.

Change Both Funding Provisions and Program Rules by Grant Consolidation

Consolidation of related programs may be applicable to vocational education and to some social service programs. Allowable activities under a single grant would be increased by consolidation, and provisions for allocating grant funds and for targeting services could be changed as well.

Vocational Education. All federal funds for vocational education--currently channeled through ten separate programs--could be consolidated and concentrated on students with special needs. Targeting could be accomplished by allocating funds, both among and within states, by formula based on the low-income, handicapped, and non-English-speaking population, weighted by age as in the current formula. Increased resources in districts with high concentrations of special needs students would likely result in improved services for them in any case, but special services for them might also be required by grant regulations. Although some school districts might receive substantially less federal funding than they do under current programs, districts with relatively large numbers of high-cost students would receive more. Even in districts that lost funding, basic programs might not be seriously affected since vocational education is strongly supported at the local level.

Social Service Programs. Some social service programs--the Community Services Block Grant, child welfare services (under Title IV-B), and services for the aging (under the Older Americans Act)--might be consolidated with the Social Services Block Grant (SSBG). The SSBG allocation formula might also be modified to target funds more on areas with concentrations of poor and elderly populations, or on areas with low fiscal capacity, as discussed in an earlier option. Currently, the SSBG is allocated on the basis of population.

Consolidation of these programs would reduce administrative costs for both federal and recipient governments without having much effect on the way spending is allocated among allowable activities, since states already have substantial flexibility under the current grants. This is because spending by state and local governments is so much in excess of what is required under current grants for child welfare and elderly services, and because such a large proportion of federal aid (nearly 50 percent) is through the very unrestrictive Social Services and Community Services block grants.

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On the other hand, while substantial support for child welfare services and for services to the elderly would likely continue in the absence of separate programs, folding current programs into the SSBG could weaken the ability of the Congress to influence the way in which these services are provided. In particular, incentives to local agencies to find permanent placements for children in foster care, introduced in 1980 by modifications to federal child welfare programs, might be reduced or eliminated. In addition, Congressional discretion in the allocation of resources among nutrition and other services provided under the Older Americans Act would be eliminated by consolidation with the SSBG. Further, it might be even more difficult to induce recipient governments to seek out the most needy among the aged population who because of disability, poverty, or lack of education might not be aware of the services available to them.

CHAPTER VI. INCOME SECURITY AND HEALTH PROGRAMS

This chapter discusses the federal role in providing income security and health benefits for individuals, and outlines some options that have been proposed to realign responsibilities between the federal government and the states in these areas. Although the chapter briefly summarizes the current federal role in all areas of federal individual-benefit provision, its emphasis is on programs providing cash assistance and health-care benefits for low-income persons and families. 1/ The public assistance programs include most of the individual benefit programs in which responsibilities are now shared between different levels of government, although some, such as food stamps, are currently funded directly by the federal government rather than through grants to states and localities. 2/

These programs differ from those discussed in the last two chapters in that in most instances they provide benefits to all qualified persons or families that apply, so that spending levels depend on the number of qualifying individuals, rather than on Congressional appropriations. Although many of these programs are classified as grants to states, almost all of them actually provide benefits directly to persons who qualify; in effect, federal spending is simply passed through by the states to those individuals entitled to benefits. Details on the operation of the specific programs covered in this chapter are given in Appendix C.

Because these programs are effectively transfers of resources that go directly to individuals, questions of effectiveness do not arise in the same way as for most other programs discussed in this paper. Transfers clearly increase the resources of their recipients by approximately the amount

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1. Only programs providing benefit payments directly to individuals--as opposed to programs that provide indirect benefits such as access to services--are considered in this chapter. Most income security and health programs fall into this category, but a few health programs, such as the Occupational Safety and Health Administration (OSHA) programs, do not and have therefore been excluded.

2. A small grant is made to states to cover part of the administrative costs for food stamps.

spent for benefits. 3/ The arguments for and against the provision of such transfers, and the characteristics of the groups that should be allowed to receive them, have been much debated, and many proposals have been advanced to reform the goals and operation of the welfare system as a whole. This chapter, however, focuses on only the small part of this debate that relates directly to the federalism issue--that is, questions concerning the jurisdiction best able and most appropriate to control and to pay for public assistance programs.

THE CURRENT FEDERAL ROLE

Programs providing income security and health benefits may be divided into two general categories: social insurance programs like Social Security, Unemployment Insurance, and Medicare, that provide benefits contingent upon previous contributions or premium payments; and public assistance programs like Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI), that provide means-tested benefits to qualifying low-income families. In addition, a small proportion of benefits for individuals (about 2 percent) are provided through programs that are not really in either category. These programs provide benefits that are neither insurance-related nor restricted to low-income households, although benefits for those with higher incomes are generally limited.

Of these three groups, the first is by far the largest: social insurance programs account for about four-fifths of total benefit payments for individuals, and Social Security and Medicare alone account for almost three-fourths. Most social insurance programs, including both Social Security and Medicare, are funded entirely through the federal budget, and responsibility for determining eligibility and administering them is for the most part exclusively federal. 4/ Contributions from individuals and

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3. Because some transfers, such as food stamps and Medicaid, take the form of payments for goods and services provided to individuals rather than cash, their value to recipients may not exactly equal their cost of provision. For further discussion of this point see Timothy M. Smeeding, Alternative Methods for Valuing Selected In-Kind Transfer Benefits and Measuring Their Impact on Poverty, U.S. Bureau of the Census, Technical Paper 50 (1982).

4. One exception is the Unemployment Insurance (UI) system which, while it is funded by both state and federal taxes, is financed primarily by state taxes on employers. Unemployment Insurance is a joint federal-state responsibility: the federal government provides general

employers are generally collected by the federal government, which maintains the records needed to determine benefits. Most social insurance programs are partially or entirely financed on a pay-as-you-go basis, in the sense that current benefits are largely funded through revenues from current contributions. Because responsibility for these programs is not now shared among levels of government, and because there are clear efficiency gains from a centralized system of record-keeping and benefit calculation in many of these programs, there have been few proposals to realign responsibilities in these areas. These programs, therefore, are not discussed further in this chapter.

Funds for most public assistance programs, on the other hand, are provided both by the federal government and by state and local governments; depending on the program, the rules that determine benefit levels and eligibility may be set at either level (see Table 9). These programs provide benefits, either in cash or in the form of goods and services, to families and individuals who meet some defined standard of need. Unlike social insurance programs, no contribution record is necessary in order to establish eligibility for benefits. Instead, public assistance programs are means-tested--that is, eligibility for benefits is limited to households with resources below some defined level. In addition, other household characteristics are generally considered in determining eligibility for benefits; most of these programs are targeted on groups that are believed to face special risks, such as children, the elderly, and the disabled.

Public assistance programs vary considerably, both in the groups served and in the way responsibilities are divided between the federal government and the states. The federal share of funding for programs such as AFDC and Medicaid is provided through grants to states, while other public assistance programs, such as food stamps and SSI, are funded directly

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4. (Continued)
guidelines and some restrictions in the operation of the state programs; it also funds benefits to certain unemployed workers and has financial responsibility for administration of the entire system. Within the constraints of federal law, states operate their own programs, establishing eligibility requirements and the duration and amount of benefits. Most proposals for change in this program have not involved a major realignment of federal and state responsibilities, but have concentrated on changes within the present structure of the program. For a description of the UI system and possible modifications, see CBO, Unemployment Insurance: Financial Condition and Options for Change (June 1983).

TABLE 9. FEDERAL EXPENDITURES FOR INCOME SECURITY AND HEALTH PROGRAMS THAT PROVIDE BENEFITS FOR INDIVIDUALS (In billions of dollars)

	1982 Actual	1983 Estimated	Percent of Total Federal Budget in 1982	Percent of Total Expenditures for This Purpose in 1982 a/
Social Insurance Programs				
Social Security Cash Benefits and Other Retirement and Disability Programs b/	181	196	25	100
Medicare c/	50	57	7	100
Unemployment Insurance d/	24	33	3	100
Subtotal	255	286	35	100
Public Assistance Programs				
Aid to Families with Dependent Children	8	8	1	54
Supplemental Security Income	8	9	1	77
Food Stamps	11	13	2	95
Medicaid	17	19	2	54
Housing Assistance	8	9	1	90
Other e/	4	4	1	100
Subtotal	56	62	8	70
Other Benefits for Individuals				
Child Nutrition Programs f/	4	4	1	60
Health Block Grants and Other Health Care Services g/	1	2	--	N/A
Subtotal	5	6	1	60 h
Total, All Benefits for Individuals	316	354	43	90 h/

SOURCE: Congressional Budget Office. Components may not add to totals because of rounding.

TABLE 9. (Continued)

a. This column shows federal program expenditures as a percentage of all expenditures--federal, state, and local--for this purpose. In many areas, percentages shown are approximations.

b. Includes Old Age, Survivors and Disability Insurance, Railroad Retirement, benefits for disabled coal miners, and federal employee retirement and disability programs.

c. Does not include offsetting receipts from premium payments of $3.9 billion in 1982 and $4.3 billion in 1983.

d. All Unemployment Insurance funds are channeled through the federal Unemployment Trust Fund, and are shown here, but most benefits--about 80 percent--are actually paid through state payroll taxes assessed on employers.

e. Includes Low Income Home Energy Assistance (LIHEA), Earned Income Tax Credit, and Refugee Assistance.

f. Includes Special Supplemental Food Program for Women, Infants and Children (WIC), National School Lunch Program, National School Breakfast Program, Childcare Feeding Program, Special Milk Program, and Summer Feeding Program. The federal government provides all of the funding for WIC, and about half of the funds for other child nutrition programs.

g. Appropriations, not outlays. Includes Preventive Health Care Block Grant, Substance Abuse and Mental Health Block Grant, Maternal and Child Health Block Grant, Primary Care Block Grant, Family Planning Program, Migrant Health Services, and Black Lung Clinics. Data on state spending since the block grants were created are not available for some of these areas.

h. Does not include health block grants.

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by the federal government. 5/ The populations served and the division of responsibilities for the major public assistance programs are summarized in Table 10 and outlined in more detail in Appendix C.

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5. States may also provide supplementary benefits in SSI if they choose.

TABLE 10. POPULATIONS SERVED AND JURISDICTIONS RESPONSIBLE FOR MAJOR PUBLIC ASSISTANCE PROGRAMS

Program	Population Served	Funding	Administration	Benefit Levels	Eligibility
AFDC	Low-income single-parent families and some low-income two-parent families with an unemployed head	Federal-state cost sharing, based on a matching formula	State and local	State determined. Wide variation among states	Categorical requirements largely federally determined. Income standards set by states
SSI	Low-income persons who are disabled or are aged 65 or over	Federal, with state-funded supplements in 44 states and the District of Columbia	Federal and state	Federal minimum benefit level, with varying levels of state supplementation	Categorical requirements federally determined. Income standards set by states, subject to federal minimum

Basis for Federal Involvement in Public Assistance Provision

Federal involvement in public assistance programs is largely motivated by a concern for the distribution of resources, both among states and localities and among low-income people in different areas of the country.

TABLE 10. (Continued)

Program	Population Served	Funding	Administration	Benefit Levels	Eligibility
Food Stamps	Low-income households	Federal	State	Federally determined. Uniform nationwide	Federally determined
Medicaid	AFDC and SSI recipients, and some other, low-income households at states' discretion	Federal-state cost sharing, based on a matching formula	State and local	Basic services federally determined. States may add some other services at their option	Minimum categorical requirements federally determined. States may choose to cover some additional low-income households
Housing Assistance	Low-income households	Federal	Federal, state, and local	Tenant rent payments set according to federally determined formula	Determined according to federal guidelines. Varies among localities

Federal participation in these programs has generally aimed to improve the adequacy of resources available to low-income people in certain categories, and to relieve hardships that might result from very low income levels. In addition, federal involvement may also reduce some spillover costs resulting from state and local activities, and, in some programs, may result in increased administrative efficiency.

Distribution of Resources. The major reason for federal participation in public assistance programs is a concern for the distribution of resources in general, and a desire to reduce hardships that could otherwise face persons in certain groups perceived to be particularly at risk. These groups include elderly persons, single-parent families with children, and disabled persons, all of whom are relatively likely to have reduced incomes. In general, means-tested income security and health programs provide cash benefits and services to low-income members of these groups, in order to help ensure their access to necessary goods and services.

Many public assistance benefits are provided at the state and local levels rather than by the federal government. Like individuals, however, states and localities have very different levels of resources available to them, and may also have different proportions of their populations in need of benefits. Thus, providing a given level of benefits for low-income persons in one of the above categories might impose much greater hardships on some states than on others, depending on states' fiscal capabilities and on the size and other characteristics of their low-income populations. In addition, states may have different views on the appropriate minimum level for benefits of various types, leading to very different treatment of similar individuals in different states. Federal participation in public assistance programs has, therefore, been justified both on the ground that some redistribution of resources across states may be necessary if major hardships are not to be imposed on some states, and on the ground that there is a national interest in certain types of support for low-income persons, which some states may not provide without federal intervention.

Under the current system of public assistance provision, states continue to have considerable discretion both over the types of low-income persons receiving benefits and, even more, over the level of benefits they receive. Although benefits are probably more uniform than they would be in the absence of any federal role, the current system guarantees neither a minimum level of benefits for all states, nor a uniform federal contribution to benefits for recipients in different states. Federal participation in this area partially offsets differences in state resources, however, since in some programs the federal share of expenditures for benefits varies inversely with state per-capita income. In addition, because the level of federal food stamp benefits depends in part on a family's income from other sources, including cash public assistance, families in states with low cash-benefit levels will be eligible to receive relatively high food stamp benefits. As a result, federal aid through the Food Stamp program partially offsets differences in the provision of cash benefits among states.

Spillovers and External Effects. To the extent that federal participation reduces the disparities between state public assistance programs, it

may also reduce spillover costs across states. Large disparities in public assistance provision may induce potential recipients to migrate to the areas with the highest benefits and most liberal program rules, which could result in an inefficient allocation of resources and in additional costs for relatively generous states and localities. In addition, the potential for such migration might encourage states to hold their benefit payments below the level that their residents would otherwise consider appropriate, in the hope of inducing eligible beneficiaries to live elsewhere. If several states pursued such policies, the costs would be borne not only by other more generous jurisdictions, but also by those low-income persons who were relatively less mobile. Thus, to the extent that there is a government interest in maintaining minimum living standards for low-income persons, the existence of such spillover effects argues for some federal involvement.

Centralized Coordination. Most public assistance programs are currently administered by state and local governments. Unlike social insurance programs such as Social Security, public assistance programs do not generally require that records be maintained over a long period of time in order to calculate benefits. Therefore, efficiency gains from more centralized administration would not, in most cases, be large. Since the populations served by the various programs often overlap, however, it is possible that some efficiency gains would result from better coordination between programs. This might be achieved through program consolidation at the state level, or through changes in federal program rules designed to facilitate better coordination.

Income Security and Health Programs: Current Policy and Effects

Existing public assistance programs address some of the federal interests outlined above, but benefit levels, and to some extent eligibility standards, are still largely controlled at the state level. There are major differences among programs, however. Some, such as the Food Stamp program, are fully funded by the federal government and also have their benefit levels and eligibility standards set at the federal level. Others, such as Aid to Families with Dependent Children and Medicaid, are partially funded by the federal government and partially funded by states. In these programs, eligibility criteria (other than income) are largely set at the federal level. Benefit levels in AFDC, and to some extent services available under Medicaid, are largely state-determined, however.

A third possible pattern is represented by the Supplemental Security Income program. In SSI, the federal government provides a minimum guaranteed income level for eligible participants, which the states may supplement. The federal government pays for benefits up to the minimum

income level, and states pay for any additional amounts. As in the AFDC and Medicaid programs, categorical eligibility standards for SSI are federally determined.

In general, there is a tradeoff in these programs between the similar treatment of similar individuals who live in different jurisdictions, and the freedom of local agencies to respond to local conditions. Thus, in a program like food stamps, all individuals across the country with similar incomes and circumstances receive the same benefits. In a program like AFDC, on the other hand, a family that is eligible in a high-benefit state might receive lower benefits or might not be eligible in a low-benefit state. Also, because benefits are determined at the state level, the range of benefits in AFDC is very large. An eligible family with three members and no other income in Connecticut or California, for example, receives AFDC benefits more than four times as high as a similar family in Mississippi or Texas. The difference in total benefits is much smaller if both families receive food stamps, since food stamp benefit levels depend to some extent on total income including cash benefits from other programs, but the Connecticut and California families still receive about twice as much in combined benefits as similar families in Mississippi or Texas.

Such differences in benefit levels may be justified by differences in costs of living among the states. For example, if the cost of living in California is higher than in Mississippi, a given quantity of benefits will buy more in Mississippi than in California. On the other hand, the cost of living probably does not vary by as much as total benefits do, and a family with dependent children and no income in California will probably be better off in terms of the buying power of its combined AFDC and food stamp benefits than a similar family in Mississippi.

OPTIONS FOR MODIFYING THE FEDERAL ROLE

Many analysts have charged that the large number of separate public assistance programs, each with different income standards and eligibility criteria, has resulted in a system that is confusing and difficult to administer. Realignment of these responsibilities among jurisdictions, however, would require some tradeoffs between federal interests on the one hand and state and local interests on the other. This section outlines some options for realignment in the income support programs, in the health care programs, and in other programs providing non-insurance-related benefits for individuals.

Income Support Programs

As outlined above, the major means-tested programs providing income support to low-income individuals and families are the AFDC, SSI, and Food Stamp programs. Although the aim of all these programs is to provide support to eligible low-income persons, they differ considerably in their approaches. This section examines three major options for restructuring the income support system as a whole: complete elimination of federal involvement, a restructuring of the system of sharing costs, and assumption of full responsibility for these programs by the federal government.

Eliminate Federal Involvement. Under this option, the individual states would assume responsibility both for program funding and for setting eligibility criteria and payment standards for those public assistance programs that are now fully or partially funded and controlled at the federal level. Thus, for example, the Food Stamp program could be turned over to the states, as was suggested by the Administration in its 1982 federalism proposal. Similarly, the AFDC program could be entirely state funded, instead of partially funded by the federal government as under current law.

Under such a plan, states would be better able to tailor eligibility criteria and program rules to those groups who are locally considered to be the most in need. Further, concentrating control over public assistance programs at one level could lead to greater administrative efficiency, perhaps allowing states to combine some programs--for example, by providing additional cash payments instead of food stamps to AFDC recipients.

There would also be some drawbacks to a plan of this type, however. First, requiring state provision of all public assistance benefits could impose substantial financial burdens on state and local jurisdictions. If no additional funds or revenue sources were turned over to the states, such a plan could result in large tax increases to support these programs or in substantial cuts in benefits. Financing difficulties could be especially serious for states with large low-income populations and relatively small tax bases.

Even if some federal revenues were also turned over to the states to help pay for income support, some problems would remain. For example, if full responsibility for public assistance programs was given to individual states and localities, it would further increase the difficulty of ensuring minimum levels of public assistance provision for groups such as the disabled, the elderly, and dependent children. In addition, such a plan could increase differences in benefit levels for similar individuals in different jurisdictions, and might lead to some spillover of costs across state boundaries if potential recipients were led to move to states with higher benefit levels.

Change to a Consistent Set of Shared-Funding Rules in All Programs. This option, which would involve restructuring the income support programs to achieve greater consistency in the federal role among programs, could be implemented in several different ways. For example, funding could be carried out through a matching formula like that used in the AFDC program, which splits the costs of benefit provision between individual states and the federal government on the basis of state per-capita income. A similar formula, or one based on a broader set of measures that might include each state's total tax base and number of potential recipients, could be used in all of the income support programs. A state-federal matching program probably results in more spending for income support than would occur in the absence of federal funding, which may be appropriate given the spillover problems discussed earlier. A matching formula based on each state's tax base and needs would also help to reduce inequities in benefit levels resulting from differences in state fiscal capacities, while allowing states considerable local control over benefit levels and eligibility standards.

On the other hand, such a system would probably result in considerable variation in benefits among jurisdictions, as now occurs, for example, in the AFDC program. Under this option, not only would total benefits received by similar individuals in different areas vary, but so would the federal contribution to those benefits. Although there may be a strong argument for state control over state benefit payments, it is more difficult to argue that federal benefit payments should differ by jurisdiction. In addition, funding benefits exclusively through federal-state matching grants, with no minimum benefit level, could lead states to lower their benefits to induce out-migration of welfare recipients with the attendant spillover costs discussed above.

A second method of sharing responsibility for income support programs between the states and the federal government would be to provide benefits at a minimum level guaranteed and funded by the federal government--as is now done in the SSI program--and to allow states to supplement those benefits if they feel it necessary and if they have the resources to do so. This would provide a uniform federal contribution to benefits in all states, and would also ensure that a minimum standard of living was guaranteed to those considered needy no matter where they lived. At the same time, such a plan would provide states and localities with some flexibility in determining benefits. If states were allowed to cover additional beneficiaries at their option, this approach would also provide them with some control over the types of beneficiaries eligible for assistance. On the other hand, it could increase federal costs, and would still leave some differences in benefit levels among jurisdictions. In addition, federal funding of a minimum benefit, without a required state match, could reduce state incentives for administrative efficiency, since some states would no longer

pay a share of the costs. Such incentives could be retained, however, either by requiring states to fund some portion of benefits at the minimum guarantee level or by penalizing states for high error rates as is now done in Medicaid.

Transfer Full Responsibility to the Federal Government. Under this option, benefit levels and eligibility criteria would be federally determined, and would presumably be uniform nationwide as they now are, for example, in the Food Stamp program. Centralized administration of income support programs might allow for better coordination among them, and between these programs and other federal activities that affect the distribution of resources among households in different income brackets. On the other hand, federal expenditures in this area would rise substantially if current benefit levels were, on average, maintained, and states were no longer required to contribute to their costs. In addition, this option would substantially lessen local control over benefit levels and program rules, and might result in programs that were less responsive to local needs and preferences.

Health Care Programs

Medicaid is the major non-social-insurance program providing health care benefits. Funding for this program is shared by the states and the federal government under a matching formula similar to the AFDC formula. The population served by the Medicaid program is very similar to the population receiving AFDC and SSI--in fact, receipt of AFDC or SSI benefits automatically confers eligibility for Medicaid, 6/ and beneficiaries under those two programs make up about three-fourths of Medicaid recipients. Thus, a change to a more uniform set of eligibility rules in those programs would also increase the uniformity of eligibility for Medicaid in different states.

As with the income support programs, the major tradeoffs involved in any change in the current system of determining Medicaid benefits would be between a desire to maintain or increase local control over the program and a desire for more uniform eligibility criteria and benefits across jurisdictions. Options for Medicaid, therefore, other than maintaining the current

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6. States have the option of limiting Medicaid coverage of SSI recipients by requiring them to meet any more restrictive eligibility criterion that was in effect before the implementation of SSI. States choosing the more restrictive criteria must allow applicants to deduct medical expenses from income for determining eligibility. Fifteen states currently employ more restrictive criteria.

system, would be to shift program responsibility to the states or to change program rules to achieve more uniformity among states, possibly increasing the federal role.

In addition to Medicaid, there are some small discretionary health programs that also provide benefits to individuals. The last part of this section examines some options for consolidating these programs.

Eliminate Federal Involvement in Medicaid. This plan would have many of the same advantages in Medicaid as in the income support programs. For example, local agencies may have greater knowledge of the needs and resources of local recipients and health care providers, and requiring more funding from state and local sources might increase the incentives of local administrators to control waste and fraud in the program. In addition, states may be more able to control health care costs than the federal government--for example, by restricting hospital expansion--and requiring states to pay more of Medicaid costs would increase their incentives to restrict cost increases.

On the other hand, increased local control in Medicaid, as in the income support programs, could lead to greater disparity in eligibility standards and benefits among jurisdictions, while increases in state and local responsibility for funding Medicaid could impose severe burdens on jurisdictions with low fiscal capacity and large eligible populations. Indeed, unless some federal revenue source was also turned over to the states, or state responsibilities were sharply reduced in other areas, assuming full responsibility for funding Medicaid would impose a great deal of strain on most state budgets.

Increase Uniformity of Medicaid Benefit Provisions. To some extent, as discussed above, greater uniformity of benefits in AFDC and SSI would automatically result in more uniform eligibility standards for Medicaid without any changes in the current program, since a large proportion of Medicaid recipients are categorically eligible for the program because they receive AFDC or SSI benefits. More uniform standards for AFDC and SSI, if they raised benefit levels in some states, could also increase Medicaid costs for those states, since more families would be eligible for cash benefits and hence for Medicaid. This could impose some hardships on poorer states. Further, some of those now eligible for benefits in high-benefit states would lose eligibility for Medicaid if they no longer received AFDC or SSI.

Another way to increase the uniformity of benefit provisions among jurisdictions, without necessarily increasing federal costs, would be to provide matching federal funds only for a consistent set of benefits and beneficiaries in all jurisdictions. Under current law, benefits that are

subject to the federal match may be extended at the discretion of each state to low-income persons who meet only some of the categorical eligibility criteria, and states may choose to cover some medical services in addition to those required under federal program rules. The groups covered and the services provided vary considerably from state to state. If, under this option, states were still able to provide additional benefits at their own expense, they would maintain some control over the types and amounts of benefits and recipients. On the other hand, this plan would result in increased costs or a reduced range of beneficiaries and covered services in many states.

Increasing federal responsibility for Medicaid would be another way to increase the uniformity of benefits among states, and could also help to equalize the impact of rising health care costs on states with differing fiscal capacities. Health care costs are growing rapidly; even with no changes in the current method of funding benefits, growing Medicaid costs may strain some state budgets, especially in states with relatively low fiscal capacity and large eligible populations. On the other hand, federal assumption of all Medicaid funding woud be very costly, and may not be feasible in a period of rising deficits without reductions in other areas of the budget.

In the Administration's original federalism proposal, a swap was outlined under which the federal government would have assumed full responsibility for most Medicaid benefits in exchange for a state takeover of the AFDC and Food Stamp programs. This proposal met with opposition from the Congress and the states, however, both because it could have lowered income support levels in some areas, and because it could have proved costly to some states. More recently, it has been suggested that the federal government assume responsibility for the acute-care portion of Medicaid, leaving the long-term-care portion, which funds nursing home care, to the states. Such a plan would give the federal government responsibility for a large share of all acute-care payments, since acute care for non-poor elderly persons is already largely funded through the Medicare program, and this might allow greater federal control over the growth in hospital and physician costs. On the other hand, the costs of long-term care are also rising rapidly, and shifting all responsibility for these benefits to the states could result both in large financial burdens for some states and in large differences in eligibility for and costs of this type of care among states.

Consolidate Some Non-entitlement Health Programs. Many smaller health programs have already been combined into block grants to states and localities in the last two years, in an effort to increase local discretion with regard to the use of the funds and to decrease federal costs. In its 1984 budget, the Administration proposed that three more of these programs--the family planning program, migrant health services, and black lung clinics--be

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added to the Primary Care Block Grant created in 1981. Elimination of these categorical programs, it is argued, would further reduce administrative costs and complexity and would give local agencies--in many cases, the same agencies that already receive funds under the Primary Care Block Grant--more discretion in allocating their funds.

On the other hand, although some funding for these programs comes from states and from private sources, the federal government provides at least 80 percent of the funds in each of these three areas, and elimination of specific federal funds for these programs could threaten their existence. Folding them into the Primary Care Block Grant would allow jurisdictions to use the funds to provide services other than those now funded under these programs. Because these programs may have significant spillover benefits not reaped by a particular jurisdiction--improvements in the health status of migrant workers, or the prevention of unwanted births that may increase future public assistance and health care costs in other states, for example--or because the costs of providing such services would fall very unevenly across jurisdictions, there may be a substantial federal interest in guaranteeing the continuance of these benefits. In addition, federal funding in these areas tends to be more closely targeted on certain sub-populations than are funds from other sources, and reducing or eliminating federally provided funds would therefore probably reduce the benefits available for these groups.

Other Benefit Programs

Finally, in addition to the income support and health care programs, there are several smaller non-insurance-related benefit programs for individuals. These include the child nutrition programs and a few public assistance programs, such as low-income energy assistance, that do not provide direct income support. Of these, the major area in which some realignment has been discussed is the set of programs providing child nutrition benefits. Options in this area include program consolidation and the retargeting of federal funds.

Most child nutrition programs provide subsidized meals for children in schools, child care facilities, and other institutionalized settings. The federal government now provides roughly half of the funds in this area; the remainder comes from states and localities and from student fees. In its 1984 budget, the Administration proposed combining three of these programs--the School Breakfast program, the Summer Feeding program, and the Child Care Feeding program--into a block grant funded at $535 million, or about 35 percent less than 1983 funding levels for these programs. The argument for this consolidation is that it would reduce costly and complex federal regulations and would increase state flexibility in providing nutrition assistance in other-than-school settings.

On the other hand, while reducing federal regulation might lower the costs of providing meals somewhat, the savings would probably be considerably less than 35 percent. This proposal could therefore result in decreased funding for these programs, unless the states were willing to allocate some of their own funds to these purposes. Reductions in subsidies might cause some schools and other groups to drop out of the program--especially those with relatively large proportions of higher-income students, whose subsidies are already small. Removal of federal regulations might also reduce program targeting on children from low-income households.

A second option for these programs would be to reduce the subsidy to higher-income students--with, possibly, a reallocation of federal funds to other nutrition programs. (One candidate for additional funding under such a reallocation would be the Special Feeding Program for Women, Infants and Children (WIC), which, because it reduces birth defects and other health problems for low-income children, has proved very cost-effective.) Reduction in the subsidy for middle-income children, whose families presumably would be able to pay the full cost of their meals, could result in better program targeting. On the other hand, it might cause many schools and other institutions to drop out of the program, thus reducing the availability of school meals for poor children.

CHAPTER VII. FEDERAL AID FOR GENERAL PURPOSES

In the 1960s, expanded federal aid was provided primarily in the form of categorical grants for specific purposes. In 1973, however, the proportion of federal aid provided for general purposes increased substantially--from 1.5 to 16.7 percent--by implementation of the General Revenue Sharing (GRS) program. That share has been declining ever since, though, as categorical aid continued to increase and GRS did not. More recently, the Administration has proposed to reduce federal grants-in-aid, and to enhance the fiscal resources of nonfederal governments by relinquishing part or all of certain federal tax bases instead.

If the basis of federal concern is that provision of certain specific public services is inadequate, categorical aid would be preferable to general purpose aid. When, however, the concern is about the general ability of nonfederal governments to provide public services, rather than about the availability of particular services, general purpose aid would be better since using categorical aid to accomplish general resource realignment would impose needless and costly constraints on recipient governments.

This chapter examines the advantages and disadvantages of alternative forms of federal aid for general purposes. The next section explores the rationale for general purpose aid to nonfederal governments. Then, the GRS program is described, followed by a section that examines options for modifying it. The last section discusses relinquishing federal tax bases.

BASIS FOR FEDERAL INVOLVEMENT

The rationale for general purpose aid to nonfederal governments is concern that some may lack the resources to maintain adequate levels of public services. In changing the distribution of resources among governments, the Congress might seek to accomplish either or both of two objectives:

- A vertical realignment of resources, from the federal to nonfederal governments;
- A horizontal realignment of resources among state or local governments.

Vertical Realignment of Resources. Some, including the current Administration, have argued that the federal government has usurped the most productive tax bases, thereby weakening state and local governments in the federal system. Vertical realignment of resources--relinquishing federal revenues or revenue sources to state or local governments--is seen as a way of reversing the trend toward growing dominance of the federal government, thus returning decisionmaking authority about local public services to state and local governments.

In principle, vertical realignment could be accomplished either by sharing federally collected revenues with nonfederal governments as general purpose fiscal assistance, or by relinquishing certain federal tax bases so that nonfederal governments could pick them up if they chose. The latter would promote greater public accountability to state and local taxpayers, since nonfederal governments would have to raise taxes in order to increase spending.

In practice, however, sharing federal tax revenues is generally more effective for vertical realignment than relinquishing federal tax bases because taxpayers can more easily avoid a nonfederal tax by moving to another jurisdiction--a concern that tends to limit the extent to which one state will raise its tax rates relative to its neighbors, and that is still more limiting for local governments. The greater a government's jurisdictional tax reach, the less vulnerable it is to interjurisdictional tax competition and the higher it can set its top rate. The limiting effects of tax competition are likely to be greater when state or local taxes must be raised to support redistributive programs than when they would provide broad-based public services since the latter would generate benefits that might compensate residents for a higher tax burden.

Horizontal Realignment of Resources. Despite a reduction in per capita income differences across states in recent years, fiscal disparities among the states have increased. 1/ Fiscal disparities among localities are

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1. In 1981, the richest state (Alaska) had 4.5 times the tax capacity of the poorest state (Mississippi), while in 1975 Alaska's tax capacity was only twice that of Mississippi. Dispersion in tax capacity around the national average has increased by more than 75 percent since 1975. This is due in part to the dramatic increase in taxable wealth in a few energy-rich states. The measure of tax capacity used--here and elsewhere in the chapter--is that developed by the Advisory Commission on Intergovernmental Relations, based on the Representative Tax System (RTS). The RTS shows how much tax revenue state and local governments could raise if they taxed all their tax bases at the

even greater than disparities among states. Although broad measures of tax capacity are not available for localities, taxable property value can be used as a measure, since three-quarters of local government tax revenues are from the property tax. In 1976 (the latest year for which data are available), dispersion in tax capacity among local school districts within a state was, on average, more than four times the dispersion in tax capacity among states. 2/

The existence of disparities in fiscal capacity among state or local governments generates concern because such disparities result either in different levels of public services across jurisdictions, or in different tax burdens that must be borne to provide the same public services. The resulting differences in public service levels or tax burdens can cause people to migrate and businesses to locate in ways that do not reflect "real" economic differences in markets and costs. Such distorted choices reduce economic efficiency and can result in the self-perpetuating decline of depressed regions.

Reducing fiscal disparities among nonfederal governments requires a redistribution of resources from high-capacity areas to low-capacity areas. Only revenue sharing based on a redistributive formula can accomplish this, since relinquishing federal tax bases would merely augment fiscal resources at their point of origin.

THE CURRENT FEDERAL ROLE

In 1983, the federal government spent $6.3 billion for general purpose assistance to state or local governments, of which $4.6 billion provided General Revenue Sharing payments to local governments (see Table 11). The remainder provided payments in lieu of taxes to the District of Columbia and other federally affected localities, and payments to states and counties from federal land and forest management activities. This section discusses only the GRS program, since all other general purpose payments are forms of compensation rather than aid.

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1. (Continued)
average tax rates for the nation as a whole. See Robert B. Lucke, "Rich States--Poor States: Inequalities in our Federal System," Intergovernmental Perspective, vol. 8, no. 2 (Spring 1982), Table 1.

2. See Eugene P. McLoone, Mary A. Golladay, and William Sonnenbert, Public School Finance: Profiles of the States, 1979 Edition (National Center for Education Statistics, 1981), Table 4.7. Property values were equalized to full market value in this study.

TABLE 11. FEDERAL GRANTS FOR GENERAL PURPOSE FISCAL ASSISTANCE (In billions of dollars in budget authority)

	1982	1983
General Revenue Sharing (local governments only)	4.6	4.6
Other a/	1.7	1.7
Total b/	6.3	6.3

SOURCE: Congressional Budget Office.

a. Includes payments in lieu of taxes to federally affected localities, and payments to states from federal land and forest management activities.

b. This does not include tax expenditures ($36 billion in 1982) or new loans ($0.3 billion). Tax expenditures include deductions for state and local taxes and the exclusion of interest on general purpose state and local debt from taxable incomes. The District of Columbia was the only recipient of federal loans in 1982.

The General Revenue Sharing Program

The GRS program distributes virtually unrestricted aid to all local governments that fit the Census definition of general purpose governments--about 39,900 in all. Originally, GRS payments were made to both state and local governments, with state governments receiving one-third and local governments two-thirds of the total funds distributed to each state area. In the 1980 reauthorization, however, state eligibility for payments was made conditional on appropriations specifically for that purpose, and no funds for states have been appropriated since then. The amount authorized for payments to local governments has remained unchanged since 1978, at $4.6 billion.

Funds are distributed to recipient governments by a three-step process. Funds are first allocated among the 50 states and the District of Columbia using the more favorable of either the Senate-designated three-factor formula based on population, relative income, and tax effort, or the

House-designated five-factor formula that adds factors for urbanized population and state income tax collections. 3/

Within each state, GRS funds are allocated through an elaborate tiering process designed to acknowledge the overlap that exists among local governments. The intrastate distribution system is meant to ensure that county areas with similar characteristics receive the same GRS aid, when payments to all jurisdictions in the county area are aggregated. Thus, a state's allocation is first divided among county areas on the basis of population, relative income, and tax effort. 4/ County-area funds are then divided into three pots, one each for county, city, and township governments, based on each kind of government's proportionate share of nonschool tax collections within the county. (School tax collections are excluded because independent school districts are not eligible to receive GRS payments.) Finally, the city and township shares are divided among all cities and townships, respectively, on the basis of their population, relative income, and nonschool tax effort. The size of any government's payment is limited, however, by several constraints that set minimum and maximum payment standards. 5/

Effects of Current Policy. GRS payments have never been large relative to spending by state and local governments, and their importance has declined steadily since the program's inception. In 1973--the first full year of the program--GRS payments accounted for 3.1 percent of all spending by state and local governments, or 2.8 percent of direct expenditures made by states and 3.3 percent of those made by local governments. By 1980--the last year payments to state governments were made--GRS had dropped to 1.9 percent of state and local spending. Payments were 1.6 percent of state spending and 2.0 percent of local spending. In 1981, when

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3. In the interstate allocation, relative income is defined as the ratio of U.S. per capita income to per capita income in the state. Tax effort is defined as all state and local tax collections in the state as a fraction of state personal income.

4. In the intrastate allocation among counties, relative income is defined as the ratio of state per capita income to county per capita income, and tax effort is the ratio of county nonschool tax collections to county personal income.

5. See Congressional Budget Office, General Revenue Sharing: The Administration's Reauthorization Proposals and Other Options for Distribution Funds (September 1980), Appendix, for a detailed description of the allocation process.

only local governments received payments, GRS accounted for 1.9 percent of direct expenditures made by all local governments.

The equalizing effects of the GRS program are also modest, both among and within states. Estimates for 1982 indicate that the effect of GRS payments was to reduce interstate disparities in fiscal capacity by less than 2 percent, on average. An allocation of funds based solely on population would have had nearly the same equalizing effect in the aggregate, although individual states would have fared differently. For example, energy-rich states with a high tax effort factor due to severance taxes would have received less. 6/ Studies of the intrastate effects of GRS payments conclude that needier jurisdictions--defined in various ways--tend to receive somewhat higher allotments than less needy jurisdictions, although governments of different types (county, city, or township) in similar circumstances may receive widely varying amounts of assistance because of the tiered allocation process. 7/ Greater equalization could be accomplished by modifying the allocation formulas, as discussed in the next section.

OPTIONS FOR MODIFYING THE GENERAL REVENUE SHARING PROGRAM

Reauthorization of the GRS program is currently pending in the Congress. Some have suggested that it should be eliminated because of the unprecedented size of federal deficits, but reauthorization seems certain. 8/ Although major changes in the program are not likely at this time, a number of proposals for modifying it (including elimination) will likely arise again in later years. 9/ The options discussed in this section include eliminating GRS or changing its funding provisions if it is continued.

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6. Congressional Budget Office estimates. See Robert B. Lucke, "Rich States--Poor States," for the methodology.

7. See Congressional Budget Office, General Revenue Sharing, p. 21; and General Accounting Office, "Removing Tiering from the Revenue Sharing Formula Would Eliminate Payment Inequities to Local Government," Report GGD-82-46, April 15, 1982.

8. Funding of $4.6 billion for GRS was included in the Administration's budget request, and $5.0 billion was included in the First Concurrent Budget Resolution for 1984.

9. The House bill (H.R. 2780) would reauthorize the current program with funding for payments to local governments increased to $5.3 billion. A

Eliminate the GRS Program

At current funding levels, eliminating GRS would reduce the federal deficit in 1984 by about 2.5 percent and would have only a small effect on federal goals for realignment of public resources, since both the vertical and horizontal realignment of fiscal resources brought about by the current program is so limited. Substantial realignment--both vertically and horizontally--would still take place through categorical aid. About 95 percent of the federal aid currently provided to state and local governments through grants would remain after elimination of GRS. In addition, more than 85 percent of the interstate equalization resulting from current federal aid would still be accomplished, due to the redistributive effects of categorical grants. 10/ Further, categorical aid would allow the Congress to ensure that federal funds are used to further federal goals.

On the other hand, the GRS program is very popular with local governments because it is the only source of federal aid virtually free of restrictions. A decline in aid available for general purposes would run counter to the goal of reducing the coercive nature of current federal-nonfederal relations. In addition, elimination of GRS would reduce the proportion of federal aid that goes directly to local governments. Local governments contend that direct aid for general purposes is important to them because their state governments are often unresponsive to their needs. It is argued that states are sometimes unwilling either to provide sufficient state aid to help local governments meet their expenditure responsibilities, or to modify the division of public service responsibilities, or to allow hard-pressed localities to expand their tax capacity by annexing surrounding areas or using new tax bases.

Change Funding Provisions

If continued, there are a number of ways in which the allocation of funds might be changed in the GRS program. The options discussed here include making state governments once again eligible for payments, modify-

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9. (continued)
bill reported out of committee in the Senate (S. 1426) would reauthorize the current program at the current funding level of $4.6 billion for payments to local governments, but would implement certain changes in the intrastate allocation process if any increased funding for payments to local governments was provided.

10. Congressional Budget Office estimates.

ing the formulas used to distribute funds among state areas, and altering the intrastate allocation process.

Make State Governments Eligible for GRS Payments. One option would be to resume GRS payments to state governments. Resumption might be justified by the states' poor fiscal condition currently. GRS payments to states were eliminated in 1980 because most states had accumulated substantial surpluses, while federal deficits were growing. 11/ In 1983, however, few states will end the fiscal year with a surplus despite recent spending reductions and tax increases during the past couple of years, because of the combined effects of recession and cuts in federal aid. On the other hand, most states expect to begin building surpluses again if the economic recovery continues, while the federal deficit is projected to increase despite recovery. Reinstituting GRS payments to state governments would either add to the federal deficit or reduce the payments going to local governments, unless offsetting actions were taken in other spending or tax programs. 12/

Resumption of GRS payments to states might also be justified by a desire to strengthen the role of states in the federal system. Some experts on intergovernmental relations have advocated the eventual channeling of most federal aid through state governments, eliminating the direct federal-to-local link characteristic of GRS and some other current grant programs. The rationale for this is that the division of responsibilities within states varies so much from state to state that federal aid directly to local governments is likely to treat similar localities in different states inequitably and to disrupt intergovernmental financing arrangements within states.

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11. Payments to local governments were continued because their fiscal condition--especially that of urban centers--was still considered precarious and because it was not certain that states would address local needs adequately.

12. One offsetting action would be to finance increased GRS by limiting the deductibility of state and local taxes, as was proposed by Senator Durenberger in the State and Local Fiscal Assistance Act (S. 700). This would, in effect, be an increase in taxes. Another offsetting action would be to require that state governments receiving GRS decline or refund an equal amount of categorical aid, which would then return to the federal government rather than being reallocated to other states. A refund requirement exists in the current legislation, but it would apparently allow categorical funds declined by one state to be reallocated to other states, and therefore would not offset federal spending for GRS payments to states.

Local governments in some states fear, however, that their state governments would be less sensitive to their needs than the federal government is.

If payments to state governments were resumed, differences among states in the division of public service responsibilities could be accommodated by dividing state and local shares for GRS funds based on their proportionate share of direct expenditures. The original one-third, two-thirds division between state and local governments was based on the fact that local governments accounted for about two-thirds of aggregate state and local expenditures, on average, at the time of enactment. 13/ In 1981, the average local share of direct expenditures was 59 percent, but it varied from a low of 23 percent in Hawaii to a high of 73 percent in Nebraska. Consequently, a uniform division of GRS funds between state and local governments in every state, based on this nationwide average, would favor local governments over state governments in states like Hawaii, and state governments over local governments in states like Nebraska. A similar effect exists in the current GRS program. Because allocations to local governments do not take account of the widely differing service responsibilities of local governments across states, GRS payments to localities in Hawaii, for example, are far more generous relative to local service responsibilities than they are in Nebraska. 14/

Modify the Interstate Allocation Formulas. The elements in the formulas used to allocate GRS funds among state areas might be changed to better reflect fiscal capacity differences. 15/ The formulas currently include population, tax effort, and per capita income. They could be changed by using a more comprehensive measure of fiscal capacity than per capita income. In addition, the tax effort factor could be modified or eliminated.

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13. Richard P. Nathan, Allen D. Manvel, and Susannah E. Calkins, Monitoring Revenue Sharing (The Brookings Institution, 1975), p. 151.

14. If GRS payments continue to be made only to local governments, the interstate allocation formula could be changed to take better account of the different service responsibilities of local governments across states by using only local tax collections, rather than state and local tax collections, in calculating the tax effort factor.

15. GRS payments could be even more highly targeted on low-capacity states if payments were made only to those states whose fiscal capacity was below the national average. Currently, some payments go to all states. This change would require modification of the structure of the GRS allocation formula.

The Representative Tax System (RTS) might be used as a more comprehensive measure of fiscal capacity than per capita income. Per capita income is a poor measure of fiscal capacity because only 19 percent of state and local tax collections is from the personal income tax, and because there is no close correspondence between the geographic distribution of income and the distribution of other state and local tax bases, such as property values and retail transactions. 16/ The RTS provides a measure of tax capacity that considers the tax revenues that could be raised by state and local governments, relative to other states, if all tax bases in the state were taxed at the average rates for the nation as a whole. The data required for updating the RTS depend in part on nongovernment sources, however, so that new government data series might have to be developed to implement this option. In addition, the RTS is itself an incomplete measure of a state's fiscal bases, since it excludes user fees, for example, such as university tuition and highway tolls. In 1980, user fees generated more state-local revenues than the individual income tax. An expanded RTS--including user fees--could be developed, but there would be difficulties in determining what new bases should be included and in maintaining accurate and up-to-date measures for them.

Although tax effort is a factor the Congress has deemed to be important in the allocation of GRS funds, the tax effort measure used is a poor one. Currently, tax effort is measured by the ratio of state and local tax collections (from all bases) to personal income in the state. As already discussed, income is only a partial measure of the tax bases a state has. One problem with the tax effort measure, then, is that it overstates the tax effort of states with substantial tax bases other than income. A second problem is that tax collections by a state may overstate taxes paid by residents of that state, because a substantial portion of some taxes may be "exported," or paid by residents of other states.

As a result of these measurement problems, the tax effort factor has distributional effects that are probably undesirable. Substantial allocations are made to energy-rich states, for example, because severance taxes--paid partly by the residents of other states--are included in the tax effort measure, while the mineral wealth on which these taxes are assessed is not. In the 1983 entitlement period, the average GRS payment per capita will be $19.91. During this period, Alaska--the richest state in the Union--will receive a per capita payment of $89.71, about 4.5 times the national average. At the same time, Mississippi--the poorest state--will receive $25.13 per capita.

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16. Nathan et al., p. 136.

The measure used for tax effort might be improved by using the ratio of tax collections to the RTS, in place of the current measure using the ratio of tax collections to personal income. This would reduce the tax effort factor for states with significant tax bases other than personal income, relative to other states. Consequently, relatively smaller GRS allocations would be made to wealthy states despite their large tax collections. It would not, however, eliminate the problem of exported taxes, with the result that states with tax collections paid in large part by residents of other states would receive the same GRS payments as other states with the same fiscal capacity but with taxes that must be paid by state residents. Although it is conceptually possible to eliminate the portion of taxes that are exported to residents of other states, it is impossible to do so with accuracy, since unknown portions of a number of different taxes are paid by non-residents. 17/

Alternatively, the tax effort factor could be eliminated because of problems in measuring fiscal capacity accurately and in eliminating exported taxes from the measure of tax collections. This would also eliminate the incentive created under the current formula for nonfederal governments to increase their tax collections in order to increase their GRS payments. There are objections to this incentive because it may induce nonfederal governments to finance services through taxes rather than through user charges, although the latter would be more efficient in some instances. 18/ In addition, the reward for tax collections under the GRS program may tend to increase the size of the government sector at the state and local level. On the other hand, the latter effect is one of the goals of the GRS program.

Alter the Intrastate Allocation Process. Two changes in the intrastate allocation process for GRS payments are discussed. First, the tiering process--by which allocations are made first to county areas, then to types of governments within county areas, and finally to individual governments--might be eliminated. Second, constraints on the minimum and maximum payments received by any government might be relaxed or eliminated. 19/

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17. Other taxes that can be exported include corporate income and both general and selective sales taxes.

18. If tax collections were expanded to include user charges, the basis for this objection would be eliminated.

19. Detiering and relaxation of the constraints on the minimum and maximum payments are changes that would be authorized under S. 1426 if additional funding for GRS payments to local governments is provided.

Modifications might also be made to the factors in the intrastate allocation formula, which has problems similar to those that were discussed in connection with the interstate formula. It is generally believed that these problems are less severe in the intrastate allocation, however, and that improvements--by development of an RTS for local governments, for example--would not be feasible at reasonable cost.

Eliminating the tiering procedure would allow all local governments within a state to compete for funds from a single state-area pot. Consequently, within each state, all local governments with similar characteristics in terms of the factors used in the allocation formula would receive similar GRS payments, regardless of their type of government. As a result, there would be equality of treatment across individual jurisdictions instead of equality of treatment across county areas. Estimates by the General Accounting Office indicate that "detiering" would increase the proportion of state-area GRS funds going to the jurisdictions in which the states' low-income populations are concentrated. It would also mean, however, that some county areas would benefit from higher payments than total income and tax effort in the county would otherwise warrant. Further, the aggregate effects of detiering would be modest since only about 3 percent of GRS funds would be shifted. 20/

Relaxing or eliminating the constraints on minimum and maximum per capita payments would help to concentrate GRS funds on jurisdictions experiencing the most fiscal distress and would reduce the tendency of current law to bolster marginally useful jurisdictions. 21/ With GRS funds distributed less uniformly among jurisdictions, however, political support for the program might decline.

About 25 percent of eligible local governments benefit from the per capita allocation floor--equal to 20 percent of the state per capita allocation. Many of these jurisdictions perform limited functions, although they meet the Census definition of general purpose governments. As a result of the minimum constraint, they receive GRS payments that are disproportionately large relative to the functions they perform, thereby reducing funds available to other jurisdictions in the state. Most counties and larger cities would gain substantially from elimination of the floor. 22/

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20. See General Accounting Office, "Removing Tiering."

21. Nathan et al., pp. 155-162.

22. Statement by Arthur R. Goldbeck, Associate Director, General Government Division, General Accounting Office before the Subcommittee on Intergovernmental Relations, Senate Committee on Governmental Affairs, April 5, 1983.

GRS payments are also subject to a maximum per capita amount--equal to 145 percent of the state per capita allocation--that limits payments received by about 3 percent of eligible jurisdictions. The primary effect of eliminating this cap would be to increase the payments going to the nation's hardest-pressed large cities. Some additional funds would also go to a much larger number of small local governments in low income areas. The net effect would be to increase the tendency of the GRS program to narrow the fiscal mismatch between central cities and the suburbs and to reduce the tendency to provide greater relief to small cities than to large cities. 23/

RELINQUISHING FEDERAL TAX BASES

The Congress might enhance the fiscal resources of nonfederal governments by relinquishing part or all of some federal tax bases, rather than providing federal aid through grants. This approach could achieve some vertical realignment of resources, but would be ineffective for reducing fiscal disparities among jurisdictions since resources would merely be returned to their place of origin.

Substantial federal aid is already provided in this way through federal tax expenditures, including the exclusion of interest on state and local debt and the deductibility of state and local taxes (see Table 12). It is estimated that in 1983 state and local governments paid $10.4 billion less in interest costs because of their ability to issue bonds that are not subject to federal taxation. In addition, individual taxpayers reduced their federal tax liability by $28.9 billion because of federal deductions for state and local taxes. Deductibility of state and local taxes does not aid nonfederal governments directly, but it may reduce resistance to state and local tax increases among those who itemize deductions on their federal income tax returns. 24/

Additional ways in which aid could be provided by relinquishing federal tax bases include:

- Allowing individuals or businesses to claim a credit against their federal tax liability for similar state or local taxes;
- Vacating certain tax bases entirely; or

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23. Nathan et al., p. 159.

24. In 1980, itemized deductions were claimed on 31 percent of returns for the individual income tax.

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TABLE 12. TAX EXPENDITURES FOR GENERAL PURPOSE FISCAL ASSISTANCE (In billions of dollars)

	1982	1983
Exclusion of Interest on General Purpose State and Local Debt	5.8	10.4
Deductibility of State and Local Taxes		
Income and sales taxes	20.4	20.1
Property taxes	10.1	8.8
Total	36.3	39.3

SOURCE: Congressional Joint Committee on Taxation.

- Providing "tax room" without entirely vacating a tax base, by cutting or holding down rates on a federal tax that is also used by nonfederal governments.

Credits Against Federal Taxes

All three approaches could augment the resources of state or local governments, but the first approach--a credit against a federal tax for similar state or local taxes--would be more effective than the last two. This is because the first approach would provide a uniform federal tax rate to serve as a kind of "umbrella" from which state or local governments could benefit. Since all taxpayers would have to pay the full amount of the tax--regardless of whether their jurisdiction took advantage of the credit--they would have no incentive to change jurisdictions in order to lower their tax burden (unless they were willing to move out of the country). Consequently, nonfederal governments would be less reluctant to impose their own taxes. There would be less accountability under the tax credit approach compared to the others, however, because there would be no political cost to nonfederal governments for raising their tax rates up to the level of the federal credit.

The federal estate tax credit is cited as evidence of how well this approach works in transferring tax resources from the federal to nonfederal governments. The federal government has allowed taxpayers to apply state estate taxes against their federal estate tax liability since 1926, with the result that all states except Nevada now levy a tax equal to or greater than the maximum federal tax credit. 25/ A second example is the tax credit employers may take for state unemployment insurance taxes against the federal unemployment payroll tax. This was effective in inducing the development of unemployment insurance systems in all states in the 1930s.

The federal government could relinquish part or all of the corporate income tax base by allowing businesses to claim a federal tax credit for corporate taxes paid to states. 26/ This would allow states to make more aggressive use of the corporate tax than they do now, because the uniform federal rate nationwide would enable them to increase their rates--up to the limit set by the federal credit--without fear of losing businesses to other states with lower corporate tax rates. Forty-six states impose corporate income taxes currently, but the maximum rate is 12 percent. A full tax credit would allow states to increase their maximum rates to the top federal rate of 46 percent. This would benefit only state governments, however, and could reduce federal revenues substantially--by up to $60 billion in 1984. If the federal tax credit was limited to half the federal corporate tax liability, states could still increase their maximum rates substantially--to 23 percent--while the loss in federal revenues would be cut in half.

An alternative would be to institute a federal general sales tax, and then to allow businesses to claim a credit for sales taxes paid to states. 27/ This would allow states with low rates to increase them--up to the federal rate--without fear of tax competition. Even states with rates higher than

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25. The importance of this credit has been reduced by recent changes in federal tax law that have eliminated federal estate tax liability on all but large estates.

26. Claiming the tax credit would be easier for businesses if their states defined taxable corporate income in the same way it is defined in the federal tax code. Some states use different definitions currently, but there would probably be pressure to adopt the federal definition if a federal tax credit was implemented.

27. Alternatively, the tax credit could be for local sales taxes, or for both state and local sales taxes. In the latter case, states might be more successful than local governments at capturing most of the benefits, though.

the federal rate might increase them by the amount of the federal tax, since there would be no reason to be more fearful of having higher rates relative to neighboring states than prior to implementation of the federal tax. This option could increase state revenues substantially with little effect on federal deficits, since the tax relinquished would be a new one. Federal income tax revenues might be reduced somewhat, however, because of increased deductions for sales taxes by individual taxpayers. In addition, this option would tend to increase state reliance on sales taxes in preference to income taxes. Some would see this as an advantage, since it would fall upon consumption rather than penalizing saving as the income tax does. Others would see it as a disadvantage, since state income taxes are probably somewhat more progressive than sales taxes, even though state income tax rates tend to be nearly constant over all taxable income classes.

Vacating or Reducing Federal Taxes

The last two approaches--vacating a tax base or reducing federal rates so that nonfederal governments could increase their tax collections if they chose--would be less effective at augmenting state and local resources because they would not eliminate the problem of tax competition among jurisdictions. If nonfederal governments fear losing business and high-income taxpayers to other communities, they may not raise taxes despite federal efforts to aid them by vacating tax bases or reducing federal tax rates. In this case, taxpayers and the private sector would benefit instead. Past experience indicates that fear of tax competition is a serious constraint. States failed to take over revenues from repeal of the federal electrical energy tax in the 1950s or from reduction of the federal excise tax on amusement tickets in the 1960s. 28/ Nor were states quick to increase their income tax rates in response to reductions in the federal income tax legislated in 1981, despite substantial reductions in federal aid. Instead, they allowed service levels to decline, cushioned somewhat by increases in minor taxes, such as taxes on alcohol and tobacco.

Current tax bases that could be vacated or reduced to aid state or local governments are limited, especially so for local governments (see Table 13). The federal government does not use the property tax or general

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28. States did pick up the real estate transfer tax (eliminated by the federal government in 1965), but this was due as much to the need for information as for revenue. See Advisory Commission on Intergovernmental Relations, "Changing the Federal Aid System: An Analysis of Alternative Resource/Responsibility Turnbacks and Program Trade-Offs" (Staff Working Paper, December 1981), Appendix F, p. 140.

TABLE 13. TAX REVENUES BY SOURCE AND LEVEL OF GOVERNMENT, 1981

Tax Base	Collections by All Governments (billions of dollars)	Percent of Collections by Government		
		Federal	State	Local
Property	75.0	0	4	96
Individual Income	332.0	86	12	2
Corporate Income	75.3	81	19	0
Customs	8.2	100	0	0
General Sales	55.6	0	83	17
Selective Sales (Excise)	70.7	57	37	6
Motor fuels	14.5	32	67	1
Alcoholic beverages	8.5	67	31	2
Tobacco products	6.6	39	59	2
Public utilities	9.0	26	47	27
Other a/	32.0	79	18	3
Estate and Gift	9.0	75	25	0
Vehicle and Operators Licenses	6.1	0	93	7
All Other	18.3	20	60	20
Total	650.2	62	23	15

SOURCE: Bureau of the Census, Governmental Finances in 1980-81, Table 4, p. 17.

a. Revenues in this group come primarily from severance taxes, including the federal windfall profits tax on oil of $23.3 billion in 1981.

sales tax, and it has already effectively relinquished the estate tax. The only widely available tax bases that might be vacated would be excise taxes on motor fuels, alcohol, and tobacco. Federal revenues from these taxes are expected to be about $21 billion in 1984. Half of these revenues--from the federal motor fuels tax--are essentially user fees earmarked for federal highway and mass transit programs, however, although it might be appropriate to relinquish some portion of them to states if they assumed greater financial responsibility for highways--as discussed in Chapter IV. It is not necessary for the federal government to vacate these tax bases in order to induce nonfederal governments to use them, though, since state and local governments have been raising their rates on these bases despite the federal presence.

APPENDIXES

APPENDIX A. BACKGROUND FOR PUBLIC WORKS INFRASTRUCTURE AND DEVELOPMENT PROGRAMS

This appendix provides background on the public works infrastructure and development programs discussed in Chapter IV. The treatment of infrastructure programs is less extensive than the background material on community and economic development, because detailed information is available in previous CBO studies, including Public Works Infrastructure: Policy Considerations for the 1980s (April 1983).

HIGHWAYS

Federal highway programs are administered by two agencies within the Department of Transportation--the Federal Highway Administration (FHWA) and the National Highway Traffic Safety Administration (NHTSA) (see Table A-1). The most important of these programs support the Federal-Aid Highway System, which has grown from 169,000 miles and 5 percent of the nation's roads in 1923 to 820,000 miles and more than 20 percent of the route-miles at present. In 1983, roughly 85 percent ($11.4 billion) of federal highway funding was allocated to programs for this system, including Interstate, Primary, Secondary (rural collector), and Urban System roads and related bridges. The remaining $2.1 billion serves a wide variety of purposes, ranging from regional development to safety-related grants, some of which are available for the Federal-Aid System as well.

Since the modern highway program began in 1916, federal highway spending has passed through several cycles. 1/ A milestone was reached in 1956, when the Congress created the Highway Trust Fund to provide a stable means of financing construction of the Interstate Highway System. Federal user fees were increased, with the most important tax--that on motor fuels--going from 1.5 cents per gallon in 1956 to 3 cents in 1957 and to 4 cents in 1959. In recognition of their importance for national growth, the

1. For more details, see Congressional Budget Office, Highway Assistance Programs: A Historical Perspective (February 1978); The Interstate Highway System: Issues and Options (June 1982); and Financial Options for the Highway Trust Fund (December 1982).

TABLE A-1. FEDERAL FUNDING FOR HIGHWAYS, 1982 AND 1983
(In millions of dollars of budget authority)

Program	1982	1983
Federal-Aid Highways		
Interstate construction	3,100	4,510
Interstate 4R a/	800	1,950
Primary System	1,500	1,890
Secondary System	400	650
Urban System	800	800
Bridges	900	1,600
Other b/	779	1,008
Total	8,279	12,408
Interstate Substitutions	400	775c/
Safety Grants d/	133	153
Appalachian Development Highway System e/	108	100
Other f/	20	36
Grand Total	8,940	13,472

SOURCE: Congressional Budget Office.

a. Resurfacing, Restoration, Rehabilitation, and Reconstruction.

b. Includes emergency relief, safety, regional development, and other special programs.

c. $518 million in Highway Trust Fund monies and $257 in general fund appropriations.

d. Includes safety grants distributed by NHTSA, as well as FHWA safety grants that are not part of the Federal-Aid program.

e. Administered by the Appalachian Regional Commission.

f. Includes access highways to public recreation areas, highway widening demonstration, and other special programs.

Interstate routes became eligible for 90 percent federal financing, rather than the 50 percent federal support that the other Federal-Aid roads received. In 1974, the federal matching share for non-Interstate projects was increased from 50 percent to 70 percent, and four years later was raised to 75 percent for most programs. Because state and local governments spend more than required to match federal dollars, federal funds account today for about half of the spending by all levels of government for construction and major repair of the Federal-Aid System.

Most federal highway grant monies are distributed to the states on a formula basis. Formulas vary significantly according to program. For example, the Interstate apportionment is based on a state's share of the cost to complete the entire Interstate System; the Interstate 4R (Resurfacing, Restoration, Rehabilitation, and Reconstruction) formula is based on need as measured by highway age; and apportionment for Primary and Secondary System funds rests on a state's area, rural population, and mileage of rural and intercity mail routes, relative to those of the nation as a whole.

The federal share of overall highway spending has averaged about 30 percent for the last 25 years. 2/ State governments now supply about half the spending, with cities, counties, and other local governments providing the remaining 20 percent. Most state and local spending goes for roads that are not included in any of the various federal systems, for the more locally oriented federal roads (mainly the Secondary and Urban systems), and for routine maintenance on all road systems.

Public spending on highways peaked in 1969 at close to $50 billion (expressed in 1982 dollars). In 1982, all three levels of government together spent about $37 billion on highways, of which about half represents capital spending for new construction and major repair work. In terms of purchasing power, this level of spending is equivalent to that of the late 1950s, shortly after the start of the federal Highway Trust Fund.

The bulk of government spending on highways is financed by taxes on highway users. The most important of these are the taxes on motor fuel--now nine cents a gallon at the federal level under the 1982 legislation, and an average of about ten cents a gallon at the state level. About

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2. Unless states increase their spending as well, the major jump in federal spending called for by the Surface Transportation Assistance Act of 1982 may cause the first major shift since the late 1950s. This legislation raised the federal tax on motor fuels from four cents to nine cents per gallon, with one penny of the five-cent increase dedicated to public transit.

95 percent of federal highway spending is financed by users, and approximately 60 percent of state and local spending also comes directly from users.

PUBLIC TRANSIT

The federal government's mass transit program, run by the Department of Transportation's Urban Mass Transportation Administration (UMTA), provides capital and operating assistance grants to local governments, with transit operators largely responsible for the selection and management of projects. Of the $4.3 billion in federal funding authorized in 1983, 80 percent ($3.4 billion) is for transit capital programs, including new bus purchases and bus maintenance facilities, modernization and extensions of existing rail transit facilities, and construction of new rail systems (see Table A-2). The remaining $0.9 billion in federal assistance is intended to help cover the operating deficits of public transit authorities.

Federal funding of mass transit began on a small scale in the early 1960s, mainly to enable localities to purchase failing private bus lines and upgrade equipment. Early in this century, mass transit was dominated by private firms that operated as profitable businesses. With the proliferation of private automobiles after World War II, however, urban populations and employment, which had once been concentrated in city centers, became more dispersed. As a result, transit ridership declined by about 65 percent between 1945 and 1965, and many privately owned transit companies failed. By the early 1960s, the physical deterioration resulting from deferred maintenance had reached crisis proportions in most of the remaining private systems. 3/

During the 1970s, federal transit aid grew at a 40 percent annual rate--faster than any other transportation program. In the early 1970s, the capital program expanded dramatically, permitting greater use of funds for both existing and new rail systems. Federal funding for approved capital grants climbed from $174 million in 1965 to $2.9 billion in 1981 (in 1982 dollars). In many cities, fares were held down to encourage ridership; but, as systems expanded, transit labor and other costs rose dramatically. As a result, operating deficits grew so large that most systems came to rely on the fare box for less than half their operating costs. In 1975, as this burden increased, operating subsidies were added to the federal aid program, peaking in 1981 at $1.1 billion (in 1982 dollars). More recently, the Surface

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3. George W. Hilton, Federal Transit Subsidies (American Enterprise Institute, 1974).

TABLE A-2. FEDERAL FUNDING FOR PUBLIC TRANSIT, 1982 AND 1983
(In millions of dollars of budget authority)

Program	1982	1983	Typical Projects Funded
UMTA Discretionary Grants (capital)	531	500	Bus fleet and service expansion
	880	840	Rail modernization and extensions
	195	206	New rail systems
	91	60	Other a/
Total	1,697	1,606	
UMTA Formula Grants	330	325	Bus replacement
	1,036	875	Operating assistance
	69	69	Small urban and rural (capital and operating) b/
	--	779	Trust Fund (capital) c/
Total	1,435	2,048	
Interstate Substitutions d/	560	365	Rail system extensions, new rail construction, bus acquisition
Washington Metro	--	240	New construction
Grand Total e/	3,692	4,259	

SOURCE: Congressional Budget Office.

a. Includes funding for privately provided public transit service for the elderly and handicapped, and the Urban Initiatives program supporting intermodal transfer and joint development projects. Urban Initiatives was discontinued in 1982.

(Continued)

TABLE A-2. (Continued)

b. Urban populations below 50,000. These areas will also receive $23 million of the $779 million in Trust Fund revenues being distributed by formula in 1983.

c. Trust Fund receipts from one penny of the federal motor fuels tax will be distributed by formula only in 1983. Beginning in 1984, they will be distributed as discretionary capital grants, at the discretion of the UMTA Administrator.

d. Transit capital projects that are substituted for withdrawn segments of the Interstate Highway System, but subject to appropriations and financed out of the general fund rather than the Highway Trust Fund.

e. Excludes transit capital projects financed out of the Highway Trust Fund's Urban Systems program.

Transportation Assistance Act of 1982 limited federal operating assistance to $0.9 billion a year through 1986.

Throughout its history, the federal program of transit capital assistance has focused on big cities. From 1965 to 1976, six large cities received two-thirds of federal capital funding commitments, and 10 urban areas together accounted for four-fifths. 4/ Even so, the very largest cities have not received funds in proportion to their shares of the nation's transit riders. This reflects an apparent desire to encourage transit growth elsewhere in the country and a belief that the largest cities may be more willing and able to finance transit on their own.

The federal share of total capital spending by all levels of government for mass transit has been about 75 percent, with state and local governments providing the remainder of the funding. Federal capital grants available through UMTA totaled $2.6 billion in 1982. At least $0.6 billion was provided by state and local governments to meet the 20 percent local

4. See Consad Research Corporation, A Study of Public Works Investment in the United States, prepared for U.S. Department of Commerce (April 1980), vol. III, pp. 52-53. In order of decreasing size of commitments, recipients include the Tri-State area constituting New York City and environs, Boston, Chicago, Atlanta, San Francisco-Oakland, Washington, D. C., Philadelphia, Baltimore, Seattle, and Pittsburgh.

matching requirements. In addition, some large cities--notably New York--financed major investments with their own monies. The federal share of transit operating costs nationwide is about 13 percent, but is less than this in large cities.

With passage of the Surface Transportation Assistance Act of 1982, the transit industry now has a dedicated revenue source--one penny of the federal tax on motor fuels--amounting to an estimated $1.1 billion a year. For 1984 through 1986, these revenues will fund transit capital grants, which are distributed at the discretion of the UMTA Administrator. The new act reduced the federal matching share on these grants from 80 percent to 75 percent. Nevertheless, after receiving federal and state contributions, a typical city may pay less than 10 percent of the costs of a project. The federal matching share on operating assistance grants remains at 50 percent.

The Surface Transportation Act also created a modified transit block grant program, to go into effect in fiscal year 1984. It will replace UMTA's existing four-tiered urban formula grant program, which provides funds primarily for operating assistance, as well as for routine capital investments such as bus replacement. The new block grant will be available for capital or operating purposes, with funds allocated to urban areas according to a formula based on population, population density, and vehicle miles of operation.

AIRPORTS

The Department of Transportation's Federal Aviation Administration (FAA) manages the user-supported Airport and Airway Improvement Program, under which the federal government offers airport authorities matching grants of 50 percent to 94 percent for construction and rehabilitation of airport facilities. In 1983, $800 million in federal spending was authorized (see Table A-3), but the Congress has imposed an obligation ceiling of $750 million.

Recognizing that an adequate system of airports was a matter of national concern, the Congress authorized the Federal-Aid Airport program in 1946. Federal capital spending on airports is financed by user fees, chiefly levied as taxes on domestic airline tickets and general aviation fuel. These taxes, which originated in 1933 and 1941, were not formally linked to expenditures until 1970, when the Airport and Airways Revenue Act established the Airport and Airways Trust Fund. Today, this fund is supported mainly by an 8 percent tax on domestic passenger tickets and a

TABLE A-3. FEDERAL FUNDING FOR AIRPORTS, 1982 AND 1983
(In millions of dollars of budget authority)

Program	1982	1983
Airport and Airway Improvement Program		
Grants-in-aid for airports	476	800
Metropolitan Washington Airports		
Operation and maintenance	30	32
Construction	17	11
Total	523	843

SOURCE: Congressional Budget Office.

14-cents-per-gallon tax on general aviation jet fuel (12 cents for gasoline). 5/ Collections from user fees are distributed to major airports in the form of matching grants determined by a formula based on passenger volume. Collections are distributed to smaller airports in the form of block grants to states.

Since 1960, cumulative investment in the nation's airports by all levels of government has totaled $25.1 billion (in 1982 dollars), of which the federal share accounts for $9 billion, or just above one-third. The year-to-year federal share of total airport investment has fluctuated widely, however, owing largely to substantial swings in the mix and total volume of airport investment. 6/ The level of federal airport spending remained relatively stable throughout the 1970s, at about $600 million a year (in 1982 dollars). Today, the federal Airport and Airway Improvement Program

5. The general aviation user fees were increased from 7 cents per gallon under the Airport and Airways Revenue Act of 1970 to 14 cents per gallon for general aviation jet fuel and 12 cents for gasoline under the Airport and Airway Improvement Act of 1982.

6. For further details, see Congressional Budget Office, Public Works Infrastructure: Policy Considerations for the 1980s, Chapter VII.

channels funds to the nation's 780 commercial airports and 2,379 general aviation facilities, including the 155 "reliever" airports, whose location enables them to help reduce congestion at major commercial airports. The federal share of capital spending averages about 20 percent for construction at commercial airports, and around 85 percent at general aviation airports.

WATER RESOURCES

While about 25 federal agencies have some authority for water resources development, federal water resources programs for financing, constructing, and operating water resources projects are administered primarily by four agencies: the U.S. Army Corps of Engineers, the Department of the Interior's Bureau of Reclamation, the Department of Agriculture's Soil Conservation Service, and the Tennessee Valley Authority (TVA). Some 20 federal acts, dating back over a century, have formed the federal water resources program for these four agencies, including development for flood control, drainage, irrigation, municipal and industrial water supply, fish and wildlife conservation, navigation, hydroelectric power, and area redevelopment. The Corps of Engineers has built and maintained inland waterways and ports under various rivers and harbors acts since 1826. All four major federal water agencies finance, build, and sometimes operate dams for a wide range of purposes. Federal spending amounting to $4.3 billion in direct expenditures was authorized in fiscal year 1983 to support these diverse water resources programs (see Table A-4).

For most types of projects, the federal government finances all capital costs but ultimately pays for somewhat less because of reimbursements from users and other nonfederal sources. Cost-sharing for joint federal/state water resources projects varies according to the type of project and lead federal agency. 7/ For the average inland waterway project, the federal government pays about 94 percent of combined capital and operating costs over the project's life. The federal government pays about 84 percent of the average commercial harbor project. The average federal share of a multipurpose dam project is about 70 percent of combined costs, but portions may vary from a low of about 36 percent for a single-purpose hydroelectric project to a high of about 89 percent for an irrigation project. States or localities generally contribute land, easements, or rights-of-way; users sometimes repay part of the initial capital cost and, more often, pay operating and maintenance costs. Together, state and user contributions cover the nonfederal share.

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7. For further details, see Congressional Budget Office, Current Cost-Sharing and Financing Policies for Federal and State Water Resources Development (July 1983).

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TABLE A-4. FEDERAL FUNDING FOR WATER RESOURCES, 1982 AND 1983 (In millions of dollars of budget authority)

Program	1982	1983
Corps of Engineers		
Construction	1,430	1,421
General investigations	137	129
Operation and maintenance	1,025	1,023
Mississippi River and tributaries	256	263
Supplemental funding a/	--	389
Total	2,848	3,225
Bureau of Reclamation		
Construction	549	580
General investigations	41	39
Operation and maintenance	119	122
Supplemental funding a/	--	116
Total	709	857
Soil Conservation Service		
River basin surveys and investigations	16	16
Watershed planning	9	9
Watershed and flood prevention operations	194	155
Total	219	180
Tennessee Valley Authority		
Water resources capital investment	19	40
Water resources operating expenses	20	23
Total	39	63
Grand Total	3,815	4,325

SOURCE: Congressional Budget Office.

a. Enacted in the 1983 Emergency Jobs Appropriation Act (P.L. 98-8).

In the early 1960s, annual federal spending for construction, operation, and maintenance of water resources projects averaged between $5.5 billion and $6.5 billion (in 1982 dollars). Since peaking in 1965, federal spending has generally declined, reaching a low point of $3.8 billion in 1982. Since the late 1970s, federal capital expenditures have declined even more rapidly. The Corps of Engineers' combined capital outlays for flood control, multipurpose dams, and navigation, for example, fell from about $2.1 billion to $1.2 billion (in 1982 dollars) between 1977 and 1983. The primary reason for such a steep decrease, besides budgetary pressures, has been the inability of the Congress and the Executive Branch to reach an accord over the proper role of the federal government in making water resources investments. As a result, no new federal water resources projects have been authorized since 1976. Overall, water resources expenditures appear to be shifting away from massive new construction projects and toward rehabilitation of existing public works and more efficient management.

WASTEWATER TREATMENT

Federal programs supporting the construction and upgrading of wastewater treatment facilities are administered by three agencies--the Environmental Protection Agency (EPA), the Farmers Home Administration (FmHA) in the Department of Agriculture, and the Economic Development Administration (EDA) in the Department of Commerce. In 1983, about $2.5 billion in federal grant assistance was authorized for wastewater treatment programs (see Table A-5). In addition, Community Development Block Grant funds, distributed by the Department of Housing and Urban Development, can be used for wastewater treatment facilities.

Federal involvement in funding wastewater treatment facilities began in 1957 under the U. S. Public Health Service (PHS). Between 1960 and 1966, only about $200 million a year (in 1982 dollars) in federal assistance went for wastewater treatment grants to states. In 1966, the PHS wastewater treatment grants program was transferred to the Department of the Interior, and in 1970--when improving water quality became a national priority because of rapidly degrading waterways and heightened public awareness--it became the responsibility of the then-new Environmental Protection Agency.

In recent years, by far the most important wastewater treatment program has been the EPA's wastewater facilities grants program, accounting for about 85 percent of all federal wastewater spending since 1970. 8/ The EPA's outlays for wastewater facilities grants more than

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8. These grants were authorized under section 201 of the Federal Water Pollution Control Act of 1972 (P.L. 92-500).

TABLE A-5. FEDERAL FUNDING FOR WASTEWATER TREATMENT, 1982 AND 1983 (In millions of dollars of budget authority)

Program	1982	1983
Environmental Protection Agency		
Construction grants for wastewater treatment	2,400	2,430
Farmers Home Administration		
Rural waste disposal grants	38a/	90a/
Economic Development Administration		
Grants for public works and development facilities	6	6b/
Total c/	2,444	2,526

SOURCE: Congressional Budget Office.

a. The FmHA provides rural water and waste disposal grants and loans to rural communities. In 1982, $125 million in grants and $375 million in loans were authorized. $300 million in grants and $450 million in loans have been authorized in 1983. Only a portion of these funds goes for construction and upgrading of wastewater treatment facilities. Based on recent spending levels, it is assumed here that, for 1982 and 1983, grants used for wastewater treatment represent about 30 percent of total rural water and waste disposal grant authorizations.

b. Estimate based on 1982 spending level.

c. Excludes federal funding for wastewater treatment available under the Department of Housing and Urban Development's Community Development Block Grant program.

doubled between 1971 and 1974, from $1.1 billion to about $2.9 billion (in 1982 dollars). Between 1975 and 1982, the EPA's outlays for wastewater treatment facilities grants ranged from $3 billion to $5 billion a year (in 1982 dollars). Under this program, the EPA now pays 75 percent of the capital costs of constructing or improving conventional, publicly owned

treatment works, and 85 percent for so-called "innovative" technologies. 9/ Beginning with fiscal year 1985, the federal matching share under this program will be reduced to 55 percent of capital costs for conventional systems and 75 percent for innovative systems. Project grants are available to states according to an allocation formula based on population and the EPA's assessment of needs. Local recipients of EPA grants are responsible for paying all operation and maintenance costs.

COMMUNITY DEVELOPMENT

A longstanding priority of local governments, community development generally encompasses those activities necessary to support and improve daily living conditions in cities and smaller communities, such as developing and maintaining streets and sewers, providing parks and recreational facilities, and constructing or improving municipal buildings. Federal community development efforts are centered in the Community Development Block Grant program administered by the Department of Housing and Urban Development. In addition, much of the federal assistance provided through infrastructure and some social service programs helps to meet local community development needs, even though these programs are not always included in the context of community development efforts.

Federal involvement in community development dates to 1949. Early federal efforts were motivated by a desire to eliminate slums and improve conditions in urban areas. Although prohibited by court decisions from directly exercising eminent domain to raze and rebuild decaying neighborhoods, the federal government funded local governments to undertake these activities through a variety of urban renewal programs of the 1950s and 1960s.

Over time, federal regulations governing local government participation in community renewal programs became increasingly extensive and restrictive, which led to reactions against the federal role in local affairs. At issue were whether the federal government appropriately had a role in addressing community development issues and, if so, what form its

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9. Under provisions of the Clean Water Act, both "innovative" (new and unproven) and "alternative" (proven in practice) technologies qualify for the higher federal share. These technologies may be more cost-effective than conventional collection and treatment systems, particularly for small or rural communities. For example, alternative treatment processes include land application of wastewater or processes that reclaim or reuse water.

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TABLE A-6. FEDERAL FUNDING FOR THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM, 1982 AND 1983 (In millions of dollars of budget authority)

	1982	1983
Entitlement Funding for Large Cities and Urban Counties	2,380	3,149
Small Cities Funding	1,020	1,243
Secretary's Fund	56	64
Total	3,456	4,456

SOURCE: Congressional Budget Office.

involvement should take. The questions were extensively debated during the Nixon Administration and resulted in the 1974 consolidation of then-current community development programs into the Community Development Block Grant (CDBG) program. 10/ The goal of consolidation was to return to local governments the responsibility for setting priorities and for developing and implementing strategies to achieve these goals. The federal role was limited to establishing broad guidelines to govern local decisions and to financing the activities undertaken.

Nearly $27 billion was spent for the CDBG program between 1975 and 1982, with an additional $4.5 billion allocated for 1983 including $1.0 billion included in the supplemental jobs appropriation bill (see Table A-6). The CDBG program has two primary components: 70 percent of annual appropriations are allocated for annual, formula-based grants to large cities and urban counties to implement locally designed development programs, while the remaining funds are used for project grants awarded to smaller communities to carry out specific activities. 11/

10. The programs consolidated included urban renewal, model cities, water and sewer facilities grants, neighborhood facilities grants, public facilities loans, open space land grants, and rehabilitation loans.

11. The division of funds between large communities and smaller ones is made after subtracting out a small amount for the Secretary of HUD's discretionary fund, which is used to make grants for special projects.

Formula-Based Entitlement Grants

Cities that have populations over 50,000 or that are designated as the central city of a standard metropolitan statistical area and all urban counties 12/ are entitled to apply for CDBG assistance and, if their applications meet statutory requirements, to receive formula-based grants. In 1982, 732 communities were eligible for entitlement grants, up from 594 in 1975. Of the total, 719 applied and were awarded grants, 12 did not apply, and 1 applied and was not awarded funds because of failure to meet application requirements.

Funding Levels. Prior to 1983, the peak funding year for community development entitlement grants was 1980, when spending reached $2.7 billion. Funding fell in each of the next two years, both because total funds for CDBG declined and because the share of the total allotted to entitlement jurisdictions was reduced in 1982 from 80 percent to 70 percent. Current funding for entitlement grants is set at $3.1 billion, as a result of higher program funding and an increased share (77 percent) of the supplemental jobs bill appropriation being allocated to entitlement jurisdictions.

Allocation of Funds. CDBG funds are distributed by formula among eligible localities. Two formulas are used, and a jurisdiction receives the higher of the two amounts. One formula, which dates to the establishment of the program, considers a community's total population, population in poverty, and number of overcrowded housing units. The second, added in 1977, includes the number of housing units in a jurisdiction built before 1940, its growth in population relative to that of all entitlement jurisdictions, and its population in poverty. In general, the earlier formula is sensitive to the needs of low-income communities, while the second is responsive to the concerns of jurisdictions with falling population levels and shifting economic bases.

Eligible Activities. Entitlement jurisdictions may use CDBG allocations for a wide range of development activities. The enabling legislation specifies that funds must be used to provide benefits to low- and

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12. Urban counties are defined as those that have populations either of 200,000 or more (not counting cities within a county's borders that are independently eligible for CDBG entitlement grants) or of 100,000 or more and a population density of at least 5,000 people per square mile and contain no incorporated places within their boundaries. Additionally, counties must have authorization under state law to carry out essential community development and housing assistance activities to qualify.

moderate-income households, to eliminate slums and blight, or to meet urgent community needs. Under the Carter Administration, regulations required that a majority of program benefits should accrue to low- and moderate-income households, and applications showing that less than 75 percent of spending aided such households were subject to special review. Under the Reagan Administration, this additional emphasis on aid to low- and moderate-income households was dropped. Bills recently reported by the House and Senate Banking Committees (H.R. 1 and S. 1338) would, however, add more specific guidance on the share of program benefits that should be realized by lower-income households.

Within this general framework, eligible activities include: the acquisition, construction, or improvement of community facilities (such as centers for the handicapped or elderly, playgrounds, and recreational facilities); public works projects (street and sewer repairs, development or improvement of water systems or storm and drainage facilities, and construction or improvement of parking facilities); housing code enforcement and assistance to remedy violations; and economic development assistance, including direct aid to for-profit firms. Up to 10 percent of CDBG funds may be used for the direct provision of social services in such areas as prevention of drug abuse, education, employment, and energy conservation.

Grants to Small Cities

In addition to entitlement grants to large cities and urban counties, the CDBG program also provides project grants to smaller communities. All general-purpose governments that do not qualify for funds under the entitlement portion are eligible to apply for small cities aid, and the same activities eligible for funding under the entitlement portion of the CDBG program may be funded under the small cities component.

Funding for the small cities component of the CDBG program rose from $259 million in 1975--when many smaller communities instead received assistance under "hold harmless" provisions that maintained through 1979 their shares of earlier, categorical programs--to $1.0 billion in 1982. With passage of the 1983 Emergency Jobs Appropriation Act, funding has risen to $1.2 billion in 1983.

CDBG assistance to small communities is administered jointly by HUD and by state governments. Funds are allocated among state areas on essentially the same basis as they are divided among entitlement

jurisdictions, 13/ and communities apply for grants to fund proposed projects. Prior to 1982, HUD awarded grants within states, but the 1981 budget reconciliation act (P.L. 97-35) allowed state governments to participate by distributing the funds within a state. In 1982, 37 states elected to do so, and in 1983 that number has risen to 49. HUD continues to distribute a state's funds when the state government has declined to participate.

To administer community development grants to small communities, a state government must develop a means of allocating funds among localities that is approved by the Secretary of HUD and must spend an amount equal to 10 percent of the state's block grant on community development activities in small communities. The strategies selected by states have varied widely, but a general trend has been to increase the number of grants made, relative to HUD's allocation practices, with the result that average grant size has decreased. In addition, the types of projects receiving funds have shifted under state government administration from housing rehabilitation, which received 43 percent of grants made in 1981 and just 12 percent in 1982, to public facilities, which received 30 percent of 1981 grants and 47 percent of those made in 1982, and to economic development, which grew from 4 percent in 1981 to 17 percent in 1982.

ECONOMIC DEVELOPMENT

The federal government has historically supported development of economic resources through programs to develop highways and waterways, through its management of natural resources, and through regulatory and tax policies. It has also promoted the development of areas that lagged behind the rest of the nation in their development, notably the Tennessee Valley in the 1930s and Appalachia in the 1960s.

In addition, since the early 1960s, it has also attempted to address the problems of areas that lack well-developed economic bases or that are experiencing disruptive shifts in their economies. Current economic development programs assist such places to develop or sustain economic activity, with the primary sources of aid being the Economic Development Administration within the Department of Commerce and the Urban Development Action Grant program administered by the Department of Housing and Urban Development.

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13. The major difference between the formulas used to allocate funds among entitled jurisdictions and the formulas used to divide funds among state areas for smaller communities is that in the 1977 formula the growth lag variable is replaced by a state's population.

Economic development activities are also independently undertaken by state and local governments, and it is difficult to say, on net, how much the federal government adds to their efforts. States and localities use a variety of mechanisms to stimulate economic growth and attract new business. Among the most common are: tax incentives, whereby governments provide exemptions, temporary tax abatements, or preferential assessments; industrial development bonds, whereby states and localities issue tax-exempt bonds to finance business relocation or expansion; and direct public services, whereby governments provide new firms with such facilities as access roads or utility connections at less than full cost. Further, some states and localities deliberately set the structure and level of their taxes so as to attract and maintain businesses. Virtually all states pursue economic development strategies with some mix of these elements, and it is likely that their efforts outweigh those of the federal government, although in both cases it is difficult to determine how much effect on economic activity these incentives and direct assistance offered to businesses produce.

Economic Development Administration

The Economic Development Administration (EDA) was established in 1965 to assist localities experiencing economic distress through a variety of means, including:

- Grants for local public works projects, including site development for industrial parks and infrastructure development;
- Grants for planning and technical assistance to communities for a variety of uses, such as export development, technology transfer, and research grants; and
- Direct loans and loan guarantees to private firms for working capital and fixed asset requirements.

State and local government eligibility for EDA assistance is based on local economic conditions, generally measured by high or prolonged unemployment or by low income. The criteria are set so loosely, however, that areas eligible for EDA aid encompass 80 percent of the U.S. population. Private firms applying for EDA credit assistance must be located in areas eligible for assistance, must be unable to obtain aid elsewhere, but must have reasonable assurance that they will be able to meet the terms of the loan.

Funding for EDA activities in 1983 is set at $298 million for grants, including $100 million added in the supplemental jobs legislation, and $150

million for loan guarantees (see Table A-7). Although no new loan authority has been provided, additional direct loans may be made from the repayments collected on outstanding loans. Of the 1983 grant funds, $230 million will be used for public works projects, $100 million of which is planned for relatively short-term, labor-intensive projects to aid areas with high rates of unemployment. The remaining grant funds will be used for other support such as planning and technical assistance. All EDA assistance is awarded by federal officials on the basis of applications from eligible governments and private firms.

TABLE A-7. FEDERAL FUNDING FOR ECONOMIC DEVELOPMENT, 1982 AND 1983 (In millions of dollars of budget authority)

Program	1982	1983
Economic Development Administration		
Public works grants	130	230
Other grants a/	68	68
Total	198	298 b/
Urban Development Action Grants	435	440
Grand Total	633	738

SOURCE: Congressional Budget Office.

a. Includes technical assistance, planning, and research grants.

b. Includes $30 million in new obligational authority transferred from revolving fund.

Urban Development Action Grants

The Urban Development Action Grant (UDAG) program attempts to link public and private investment directly by aiding projects that are

actively supported by local governments and that have firm commitments from private developers. Cities identify projects that are not likely to be undertaken by the private sector alone but that have the potential for furthering economic activity within a distressed area. Officials secure private commitments to the project and request UDAG aid to provide public services or financing. UDAG funding is to be provided only if the project could not proceed in its absence.

UDAG assistance is limited to localities experiencing economic distress, measured by such factors as their rates of growth in population, income, and retail and manufacturing employment; their rates of unemployment; the proportion of population with incomes below the poverty line; and the age of the housing stock. Local governments that do not meet these requirements may still apply for action grants if the planned project would be located in an area within the jurisdiction that is economically distressed. UDAG funds are awarded on a competitive basis among eligible jurisdictions.

Funding for UDAG in 1983 is set at $440 million, down from a peak of $675 million in 1980 and 1981, to fund a variety of commercial, industrial, and housing projects. About 60 percent of program funds to date support commercial projects such as the development of office buildings or hotel complexes; 25 percent has been used for industrial projects such as the expansion or relocation of small electronics firms; and the remainder has been used for housing. UDAG funds may fill a variety of roles in development projects, including: direct subsidies to developers through loans, interest reductions, or land write-downs; provision of infrastructure required for the project; or payment of relocation expenses associated with a project.

APPENDIX B. BACKGROUND FOR EDUCATION, EMPLOYMENT, AND SOCIAL SERVICE PROGRAMS

This appendix discusses the operation and effects of most current intergovernmental grant programs for education, employment assistance, and social services. Education programs are divided into two groups--programs for students with special needs, and others.

EDUCATION PROGRAMS FOR STUDENTS WITH SPECIAL NEEDS

More than 70 percent of federal grant dollars for elementary, secondary, and vocational education--about $4.6 billion in 1983--fund programs for students with special needs. 1/ These include compensatory programs for low-income and underachieving students, educational and other services for handicapped students, and bilingual education for non-English-speaking students (see Table B-1). Additional federal funding for compensatory services is available through Head Start, a social service program for preschool children from poor families.

The role of federal funding differs between compensatory programs, on the one hand, and handicapped and bilingual programs on the other. Unless they accept federal funds for that purpose, schools are not required to provide compensatory education to underachieving students. Federal courts have ruled, however, that special efforts to facilitate access to mainstream public education for handicapped and non-English-speaking children are required under the law, whether or not federal funds are received by the schools for that purpose. As a result, federal programs for the handicapped and for bilingual education help to support activities that schools must undertake in any case, while federal programs for compensatory education provide funding for services that many schools might otherwise not provide.

Compensatory Programs

Title I/Chapter I of the ECIA. Title I of the Elementary and Secondary Education Act--as modified by Chapter I of the Education Con-

1. In addition to grants, the federal government supports and administers some education programs for Indians and migrants directly.

TABLE B-1. GRANTS FOR THE EDUCATION OF STUDENTS WITH SPECIAL NEEDS, 1982 AND 1983

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
COMPENSATORY EDUCATION b/				
Title I/Chapter I of the Education Consolidation and Improvement Act (ECIA)	3,034	3,200	Formula grants to states based on state expenditures per pupil and low-income school-age population. Most funds passed on to local education agencies	Underachieving students in low-income school districts
Vocational Education Act: Special Programs for the Disadvantaged	14	14	Formula grants to states based on income and school-age population	Economically or educationally disadvantaged students
Adult Education Act	86	95	Formula grants to states based on the number of adults with less than a high school education. Recipient cost-sharing (10 percent)	Adults lacking a high school degree
HANDICAPPED EDUCATION c/				
Education of the Handicapped Act	1,069	1,199	Mostly formula grants to states based on the number of handicapped students, with pass-through to local agencies	Handicapped students

TABLE B-1. (Continued)

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
BILINGUAL EDUCATION d/				
Bilingual Education Act	134	134	Project grants to state, local, and non-profit educational institutions	Children with limited proficiency in English
Vocational Education Act: Bilingual Training	4	4	Project grants to state, local, and non-profit agencies	Adults who are under-employed due to limited proficiency in English

SOURCE: Catalog of Federal Domestic Assistance.

a. Congressional Budget Office estimates. For some programs, budget numbers include small amounts not distributed as grants but used for associated federal activities.

b. Additional funding for the disadvantaged is provided through a 20 percent setaside required in vocational education basic programs.

c. Additional funding for the handicapped is provided through a 10 percent setaside required in vocational education basic programs, and through state programs for the handicapped under Title I/Chapter I of the ECIA.

d. Additional support for language training for those whose proficiency in English is limited is provided through Title I/Chapter I of the ECIA, Head Start, and Adult Education programs.

solidation and Improvement Act (ECIA) of 1981--is the largest source of funding for compensatory education, and provides half of all grants for elementary and secondary education--$3.2 billion in 1983. No state or local match is required under the program. In more than half the states, the ECIA is the only source of funds for compensatory education. In the 18 states that had state programs in the 1978-1979 school year, federal dollars provided, on average, more than 70 percent of total federal and state funding for compensatory education. Nationwide, federal dollars provided nearly 80 percent of all funding for compensatory education.

Under Title I, Part A, formula grants are distributed among and within the states on the basis of state school expenditures per pupil and the relative number of school-age children from low-income families, although at the school level compensatory services are targeted on underachieving children regardless of family income. 2/ Almost 90 percent of school districts receive some funds under Title I, but districts with large concentrations of poor children receive larger per pupil allocations.

Strict regulations governing the use of Title I funds have resulted in well-targeted programs of supplemental services--provided primarily to elementary school students--that have increased educational performance relative to comparable non-Title I students. Although relative performance has been improved, the benefits of compensatory education have not been great enough for Title I participants to "catch up" with nondisadvantaged noncompensatory students. Further, it is unclear how long the relative gains made by Title I participants are sustained. Preliminary evidence over a three-year period indicates that most gains are made in the first year of Title I participation, and that although Title I graduates do not generally fall back in reading skills, mathematical skills decline after participation ceases. 3/ Finally, the amendments to Title I authorized by Chapter I of the ECIA may reduce the targeting and hence the efficacy of these compensatory programs, beginning with the 1982-83 school year.

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2. About 85 percent of Title I funding is for Part A programs for local education agencies. There are several smaller programs under Part B, for services provided by state agencies to institutionalized and migrant children.

3. See U.S. Department of Education, "An Evaluation of ESEA Title I--Program Operations and Educational Effects: A Report to Congress" (March 1982), Chapter IV.

Vocational Education Programs. A second source of federal funding for compensatory services occurs through special programs for disadvantaged students under the Vocational Education Act, as well as through a 20 percent setaside in basic vocational programs. It appears that the provisions of the Vocational Education Act have induced states to make a greater effort to serve disadvantaged students from their own resources as well. Although the proportion of state-local vocational expenditures devoted to this purpose is modest--only about 10 percent--this reflects a state-local contribution to services for the disadvantaged that exceeds federal matching requirements. (For example, states contribute more than a third of the funding for special programs for the disadvantaged, although no match for federal funds is required in these programs.) It is not known, however, whether the supplemental services provided to the disadvantaged result in educational or employability gains relative to similar students not receiving services. 4/

Adult Education. Federal support under the Adult Education Act provides formula grants to states to reduce functional illiteracy, by paying up to 90 percent of the costs of remedial courses for adults lacking a high school degree. Federal funds have apparently induced an increase in the number of classes held and the number of disadvantaged adults served, with states paying a growing share of the costs for these programs. Estimates for 1982 indicate that states matched federal funds dollar for dollar, paying 50 percent of program costs.

Education of the Handicapped

Limited federal funding for education of the handicapped--special education--was available earlier, but federal funding increased substantially in 1975 with amendments to the Education of the Handicapped Act (EHA). That is now the major source of federal funding--providing $1.2 billion in 1983--although some additional funding is provided under Chapter I of the ECIA (for handicapped children in state institutions) and through a 10 percent setaside in basic programs under the Vocational Education Act. Most funding under the EHA is allocated among the states on the basis of the number of handicapped children aged 3 to 21 receiving special education and related services. In addition, about 12 percent of federal funding is allocated on a discretionary basis for special purposes, such as removal of architectural barriers and personnel development. Federal funding is less than 10 percent of all public spending for special education.

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4. See U.S. Department of Education, "Vocational Education: Report by the Secretary of Education to the Congress, 1981" (June 1982), Table 2; and The National Institute of Education, The Vocational Education Study: The Final Report (September 1981).

Because supplemental services necessary to assure access to public education for the handicapped are required under the law, whether or not federal funding is provided to pay for them, federal education programs for the handicapped probably have little effect now on whether or not some services are provided. 5/ They may, however, affect the amount and kind of services provided, since states that accept federal dollars for special education are then bound by federal program mandates and regulations. 6/

In particular, the EHA prescribes that handicapped children be educated in the "least restrictive" environment, which means that handicapped children are to be served in regular rather than segregated classes if at all possible. This has led to complaints by local educators, who contend that they are in a better position to determine the appropriate educational approach for the handicapped children they serve. They argue that, in some instances, education for both handicapped and other children would be improved if the handicapped were educated separately in special education classes. This is because few regular classroom teachers have the training to

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5. The educational rights of handicapped children were established initially in two major state-level suits: Pennsylvania Association for Retarded Citizens v. Commonwealth of Pennsylvania; and Mills v. D.C. Board of Education. At the national level, there are two federal laws intended to assure certain rights to handicapped persons: Section 504 of the Rehabilitation Act of 1973 prohibits any program or activity receiving federal assistance from discriminating against persons because of a handicapping condition; and Part B of the EHA requires that each state participating in the state grant program provide a "free appropriate public education" to all handicapped children 3 to 21 years of age in the "least restrictive environment." In July 1982, the Supreme Court began the task of defining reasonable limits to the rights of handicapped children by deciding that very high-cost types of help--such as a sign language interpretor for a single child--were not required when the child was making "reasonable progress" without them (Hendrick Hudson District Board of Education v. Rowley). See Congressional Research Service, "Education of the Handicapped," Issue Brief 78040, April 14, 1982.

6. For the 1978-1979 school year, New Mexico was the only state that did not apply for a grant under Part B of the EHA. Even states that refuse EHA funds may comply with EHA regulations, though, since compliance with the EHA regulations is one way to demonstrate compliance with the more generally applicable requirements of Section 504 of the Rehabilitation Act.

deal effectively with handicapped children, so that the children make less progress than they might if they had the attention of a special education teacher. In addition, the behavior characteristic of certain disabilities can be seriously disruptive of regular classroom activities.

Another major complaint with the EHA centers around the non-educational services--such as special medical and transportation services--that are required for some students. Critics argue that it is not appropriate to impose the sometimes large and uncontrollable costs of these related services on the educational system. One study found that 25 percent of one state's school transportation budget was spent on handicapped children, although they were only 3 percent of the total school population. In addition, the study found that some state non-educational agencies had eliminated services to handicapped students because they assumed that educational agencies were receiving enough federal funds to take responsibility for the necessary services. 7/

Supporters of the current requirements contend, however, that they are needed to counter the tendency of some school districts to ignore the special needs of handicapped children, or to offer them inferior services in segregated classes. Although it seems clear that educational opportunities for handicapped children have increased substantially as a result of court decisions and legislation in the last decade, there is little evidence on the relative effectiveness of alternative approaches to education for the handicapped. To date, most research has been confined to measuring compliance with regulations.

Bilingual Education

The educational rights of non-English-speaking children, like those of handicapped children, are protected by law whether or not federal funding is available to pay the costs. 8/ Federal civil rights enforcement and grant programs have emphasized bilingual education--some instruction in the child's native language--in preference to English-only alternatives as the means to ensure these rights.

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7. See "P.L. 94-142: A Study of the Implementation and Impact at the State Level" (Education Turnkey Systems, 1981).

8. In a 1974 decision (Lau v. Nichols), the Supreme Court decided that special efforts to assimilate non-English speaking children in public schools are required under Section 601 of the Civil Rights Act of 1964, which bans discrimination based on national origin in any program or activity receiving federal assistance.

Most federal funding is provided under the Bilingual Education Act of 1968 (Title VII of the Elementary and Secondary Education Act), although some support for bilingual vocational training is available under the Vocational Education Act. 9/ Under Title VII, project grants--totalling $134 million in 1983--are awarded on a competitive basis to state and local education agencies in order to facilitate the development of their capacity to provide bilingual education, with rapid withdrawal of federal support once this goal is met. In 1982, 43 states received Title VII funds, but about half the projects (and funds) were in just three states--California, New York, and Texas.

Local educators have argued for greater flexibility in addressing the needs of non-English-speaking students, on two grounds. 10/ First, they maintain that it is not feasible in many areas to provide instruction in the native language of each student because so many different languages are represented. Second, they argue that alternative techniques, such as English as a Second Language or structured immersion programs, are often more effective. A review of research on bilingual education programs supports local claims about the need for greater flexibility. Based on these findings, a report prepared by the Department of Education states that "continued Federal pressure for bilingual education /to the exclusion of other approaches/ warrants reexamination," and that "the problems of language-minority children are too complex to lend themselves to one nationally mandated instructional approach." 11/ The Administration is seeking legislative changes in Title VII to allow alternatives to bilingual education.

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9. In addition, some language training is provided under Title I, Head Start, adult education programs, and refugee assistance programs.

10. The first instance in which an all-English program was accepted as fulfillment of federal civil rights requirements occurred in December 1980, when the U.S. Department of Education told Fairfax County, Virginia, that it was not required to teach students in their native language. Fairfax County has an English as a Second Language program. The burden of proof has rested with the local school system to prove that alternative approaches are superior to bilingual instruction, however. See Congressional Research Service, "Bilingual Education: Federal Intervention or Equal Access?" Issue Brief 80093, January 15, 1982.

11. Beatrice Birman and Alan Ginsburg, "Addressing the Needs of Language-Minority Children: Issues for Federal Policy," U.S. Department of Education (October 5, 1981), pp. 1 and 11.

OTHER EDUCATION PROGRAMS

In contrast to the programs examined in the previous section--which support supplementary educational activities that were rare prior to federal mandates or funding--the grant programs discussed in this section support general educational activities at the state and local level. These include basic vocational education programs, Chapter II of the ECIA, and impact aid (see Table B-2). Spending for these programs accounts for less than 30 percent of all federal aid to elementary, secondary, and vocational education--about $1.7 billion in 1983. In addition, this section discusses programs that provide grants to improve library services. 12/

Vocational Education

Federal support for vocational education is longstanding, dating back at least to the Civil War at the postsecondary level and to 1917 at the elementary and secondary level. Current support--a total of $725 million in 1983--is authorized under the Vocational Education Act of 1963 and subsequent amendments. Most funds are distributed among states and then to local education agencies through a formula based on population and per capita income. States are required to match the federal contribution dollar-for-dollar in basic programs, but overmatching is so large that federal dollars make up less than 10 percent of all public spending for vocational education. This suggests that federal programs have little effect on the overall level of spending, although (as discussed earlier) special programs and setasides targeted on students with special needs have influenced the composition of spending. Nearly one-third of federal dollars are targeted on students with special needs.

There is no strong evidence that vocational education programs are effective. At the secondary level (which receives 80 percent of federal funds), there is no apparent long-term advantage for vocational education students relative to general curriculum students, although there are short-term gains in employment and earnings for women in office skills programs and (to a lesser extent) for men in industrial education. There is very weak evidence that vocational education may reduce high school dropout rates,

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12. Federal spending for postsecondary education--$7.4 billion in 1983--is mostly financial aid provided directly to students, through guaranteed student loans, Pell grants, and campus-based programs. Since these are not intergovernmental grant programs, federal aid for postsecondary education is not discussed here.

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TABLE B-2. GRANTS FOR GENERAL EDUCATION AND RELATED PROGRAMS, 1982 AND 1983

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
Vocational Education Act: Basic Programs b/	634	707	Formula grants to states based on population and income. Recipient cost-sharing (50 percent) usually required	Vocational education students
Chapter II of the Education Consolidation and Improvement Act (ECIA)	484	479	Mostly formula grants to states based on school-age population. Minimum 80 percent pass-through to local education agencies	School children
Impact Aid	466	540	Mostly formula grants to local education agencies based on number of federally connected children and per-pupil costs	School districts with federally connected children
Library Programs	80	130	Mostly formula grants to improve library services. Recipient cost-sharing (33 to 67 percent) usual	Patrons

SOURCE: Catalog of Federal Domestic Assistance.

a. Congressional Budget Office estimates. For some programs, budget numbers include small amounts not distributed as grants but used for associated federal activities.

b. Excludes Special Programs for the Disadvantaged and Bilingual Training, which are shown in Table B-1.

but that it may also reduce the rate of college attendance. Postsecondary vocational education appears to be more consistently related to earnings gains for both men and women, with the increase somewhat larger for non-whites than for whites. 13/

Chapter II of the ECIA

The State Education Block Grant is authorized under Chapter II of the ECIA, which consolidated about 30 small categorical aid programs. Most of the antecedent programs were project grants awarded competitively at the federal level, with urban school districts as the major recipients. The activities for which categorical aid was available included emergency school aid for desegregation activities and career education programs, among others. 14/ Under the block grant, funds are distributed by formula to the states, with a mandatory minimum passthrough of 80 percent to local education agencies. Funds may be used for any of the purposes of the previous categorical programs, but they represent less than 0.5 percent of all spending for elementary and secondary education. 15/ Up to 6 percent of funds appropriated for Chapter II of the ECIA may be used by the Secretary of Education for discretionary projects.

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13. See Robert H. Meyer, "An Economic Analysis of High School Vocational Education," Parts III and IV, Urban Institute Project Report (August 1981); National Commission for Employment Policy, The Federal Role in Vocational Education (September 1981); National Institute of Education, The Vocational Education Study: The Final Report (September 1981); and National Center for Research in Vocational Education, The Effects of Participating in Vocational Education: Summary of Studies Reports Since 1968 (May 1980).

14. Follow Through--a program that provides continuing compensatory services to Head Start graduates once they enter regular school programs--was retained as a categorical program for three years, after which it will be funded only through the block grant. See Advisory Commission on Intergovernmental Relations, A Catalog of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded in 1981 (February 1982), pp. 67-69 for a list of the categorical programs consolidated into Chapter II of the ECIA.

15. See Congressional Research Service, "Impact of Budget Changes on Major Education Programs, Both Enacted and Proposed, During the 97th Congress," Issue Package 0199E, February 1982, pp. 1-4.

The block grant is essentially equivalent to unrestricted aid to education. Although the Congress reiterated its commitment to the basic goals of the predecessor programs when it created the grant, it is not effectively targeted at those goals. This is because funds are allocated on the basis of school-age population, rather than on the basis of any criterion related to the goals of the predecessor programs, and because federal oversight and control are minimal.

Impact Aid

Impact aid provides unrestricted payments intended to compensate local school districts whose tax bases are reduced or whose enrollments are increased because of federal installations. The need for federal aid arises because federal property has been exempted from state and local taxation by the Congress. As a result, private property holders in federally affected localities pay higher property tax rates to finance local services than they would if all property in the locality was privately owned and taxable. In recognition of this difference in treatment and of the value of local services used as the result of federal installations, the federal government has a number of programs that make payments in lieu of taxes to federally affected localities. Impact aid is the largest of them.

In 1983, impact aid payments amounting to $540 million were made to federally affected school districts. Most payments are allocated to local school districts by a formula based on the number of federally connected children enrolled and on local per pupil expenditures. Two classes of federally connected children are distinguished: Class A children, whose parents both work and live on federal property (including children who live on Indian lands); and Class B children, whose parents either work or live on federal property. The payment per pupil is currently less for Class B children than for Class A children, and all payments for Class B children are to be phased out by 1985. 16/ The reasoning behind this--as argued by both current and previous Administrations--is that districts with Class B children are not adversely affected by the federal presence, since economic activity and off-site tax revenues are increased by parents who work or live outside the installation. 17/

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16. A three-year phaseout of payments for Class B children beginning in 1982 is a provision of the Omnibus Budget Reconciliation Act of 1981. Even for Class A children, the program is not fully funded so that the payment per child is less than per pupil expenditures.

17. See Congressional Research Service, "Education: Impact Aid--FY 83 Funding Levels and Priorities," Issue Brief 79018, April 1982.

Districts may be less adversely affected by Class B children than they are by Class A children, since off-site property, income, and sales tax collections are likely to be higher due to the activities of the parents of Class B children. This difference may be small, however, since in many areas only increases in off-site property tax collections benefit the affected school districts directly. Increased income and sales tax collections are more likely to accrue to state governments. It would probably be more equitable to replace the current collection of payment schemes that compensate localities for federal installations with a comprehensive program of payments in lieu of taxes, based explicitly on the property tax revenues that would be due if federal property were taxable.

Library Programs

Federal support for library services--$130 million in 1983--comprised less than 5 percent of all public spending for library services. About 45 percent of federal funds were allocated through a population-based formula to states to improve library services in underserved areas. A succession of federal administrations have sought to eliminate the federal contribution to library services, or to limit it only to funding for underserved areas, arguing that relieving inadequate library services is a low priority item for scarce federal dollars, particularly since there is no evidence that the public (as distinct from the providers of services) perceives any serious inadequacy in the availability of library services. Service providers, on the other hand, maintain that federal support is important because the continuing "information explosion" and the development of new and expensive technology to improve its availability have made it increasingly difficult for all but a few major libraries to store all this information. 18/

EMPLOYMENT ASSISTANCE PROGRAMS

The federal government provides employment assistance in two ways: it funds training and employment programs for selected groups; and it supports the information and placement activities of the Employment Service (see Table B-3). 19/ Employment assistance programs--which are

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18. See Advisory Commission on Intergovernmental Relations, Federal Involvement in Libraries (June 1980).

19. Job creation is also one of the goals of community and regional development programs (discussed in Chapter IV) in addition to improv-

(Continued)

TABLE B-3. GRANTS FOR EMPLOYMENT ASSISTANCE PROGRAMS, 1982 AND 1983

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
Training and Employment				
CETA/JTPA: Programs for the Disadvantaged b/	2,964 c/	3,852 d/	Mostly formula grants to state, local, and non-profit agencies based on low-income and unemployed population	Economically disadvantaged workers
Work Incentive Program	281	271	Formula grants to state welfare agencies based on the number of WIN registrants. Recipient cost sharing (10 percent) required	AFDC recipients
Older Americans Act: Community Service Employment	277	319	Project grants to state, local, and nonprofit agencies. Recipient cost sharing (10 percent) required	Low-income workers aged 55 or more

TABLE B-3. (Continued)

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
JTPA/TAA: Dislocated Worker Programs	25	135	Project and formula grants to states. Recipient cost sharing (up to 50 percent) required	Dislocated workers
Employment Service	757	824	Formula grants to states based on labor force size and number unemployed	Unemployed workers and employers

SOURCE: Catalog of Federal Domestic Assistance.

a. Congressional Budget Office estimates. For some programs, budget numbers include small amounts not distributed as grants but used for associated federal activities.

b. The Comprehensive Employment and Training Act (CETA) was replaced by the Job Training Partnership Act (JTPA) in October 1982, but 1983 is a year of transition. JTPA should be fully implemented by October 1983. Unlike CETA, JTPA includes a title that authorizes grants to states for providing employment services to dislocated workers.

c. Includes $826 million for federally administered programs, including the Job Corps and national programs for Indians and migrants.

d. Includes $866 million for federally administered programs.

heavily targeted on economically disadvantaged persons in the labor force--are designed to complement general economic policies intended to maintain the economy at full employment, since past experience shows that prosperity alone will not suffice to integrate workers with severe disadvantages into the labor market.

Training and Employment Programs

The federal government supports job training programs for two kinds of workers--those who are economically disadvantaged and those who have been dislocated by structural changes in the labor market. Currently, almost all federal funding for job training programs is targeted on disadvantaged workers. Funding for programs for dislocated workers--provided under the Trade Adjustment Assistance (TAA) provisions of the Trade Act of 1974--was less than 1 percent of total federal spending for training and employment programs in 1982. This share rose to 3 percent in 1983, though, and is likely to increase further as the new Job Training Partnership Act (JTPA)--which authorizes a new program for dislocated workers in addition to programs for disadvantaged workers--is fully implemented in 1984 as a replacement for the Comprehensive Employment and Training Act (CETA).

Programs for Disadvantaged Workers. JTPA is the largest source of funding for employment and training for disadvantaged workers. Funding under JTPA was $3.9 billion in 1983. Some additional employment and training for disadvantaged workers is provided to AFDC recipients under the Work Incentive (WIN) program, while public service employment is provided to low-income older workers through the Community Service Employment (CSE) program. The federal government administers directly some job training programs--the Job Corps for youth, and special programs for migrant and Indian workers--but most federal training programs are administered by state or local agencies that receive federal grants. CETA grant programs (and the new programs for the disadvantaged under the Job Training Partnership Act) are 100 percent federally funded, while a 10 percent state-local match is required under the WIN and CSE programs. Typically, there has been little overmatching by nonfederal governments in

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19. (Continued)
ing the physical environment and the fiscal capacity of targeted areas. It seems unlikely, however, that current economic development programs have been very successful at generating private employment demand in depressed areas. See John L. Palmer and Isabel V. Sawhill, ed., The Reagan Experiment (The Urban Institute, 1982), pp. 263-267.

these programs. Responses to the substantial reductions in funding for federal training programs in 1981 and 1982 indicate, however, that state and local governments might step in to cushion reductions in service levels at least for summer youth employment programs. 20/

Evidence on the effectiveness of employment and training programs for the disadvantaged is mixed. Intensive programs in remedial education and training--like the Job Corps--have been successful at increasing the employability and earnings of severely disadvantaged youth, but less intensive programs providing primarily work experience--characteristic of most CETA youth programs--typically have not. For youth who already have basic employment skills, much less costly programs providing intensive job-search assistance have been successful at increasing employment rates by reducing the time these youth spend looking for work. 21/ For adult women entering the labor force for the first time, or reentering after a number of years, it appears that most approaches--work experience, classroom instruction, or on-the-job training--are equally successful at increasing employability, indicating that the least costly approach would be most cost-effective. Job-search assistance alone might be equally effective for these women, at a lower cost, but this is uncertain. By contrast, none of these approaches appears to enhance significantly the employability or wage rates of adult men with a history of low-wage or unstable employment. 22/

Programs for Dislocated Workers. Workers dislocated for any reason (trade-related or not) are eligible for employment services--including training and relocation allowances--under Title III of the Job Training Partnership Act (JTPA). 23/ Start-up funding of $110 million has been provided for 1983 under this program, including supplemental appropriations of $85

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20. See Richard P. Nathan, Philip M. Dearborn, and Clifford A. Goldman, "Initial Effects of the Fiscal Year 1982 Reductions in Federal Domestic Spending," in John William Ellwood, ed., Reductions in U.S. Domestic Spending (Transaction Books, 1982).

21. See Congressional Budget Office, Improving Youth Employment Prospects: Issues and Options (February 1982).

22. See Congressional Budget Office, CETA Training Programs--Do They Work For Adults? (July 1982).

23. Estimates of the proportion of the unemployed who are dislocated range from 1 to 20 percent, depending on how dislocation is defined. See Congressional Budget Office, Dislocated Workers: Issues and Federal Options (July 1982).

million under the emergency jobs bill recently enacted (P.L. 98-8). Additional funding of $25 million is available under the TAA program for workers dislocated by increased imports, but this program is due to expire at the end of 1983.

Evidence on the effectiveness of readjustment programs for dislocated workers is scarce, but there are indications that job search assistance can improve labor market outcomes for dislocated workers, often without the need for extensive job retraining. In pilot projects offering reemployment services to workers permanently laid off from automotive supply plants in Michigan, it was found that workers who received services were significantly more likely to find new employment than workers who did not receive special services. Reemployment rates for those who received services were 72 percent, compared to 50 or 60 percent for those who did not receive services. The results indicated that training plus job search had no greater impact on reemployment rates than job search alone, but this finding must be viewed with caution since participants assigned to training were those the program staff believed would be less likely to find reemployment without training. 24/

The TAA program, however, has been more one of income maintenance than of adjustment. Of those who received trade readjustment allowances from 1976 through 1980, about 13 percent received counseling, fewer than 3 percent were referred for training, and about 3 percent were placed in new jobs. Since more than two-thirds of workers who received TAA benefits returned to their former employment, they were not really dislocated workers. 25/

The Employment Service

The principal public source of labor market information and placement assistance is the U.S. Employment Service, authorized by the Wagner-Peyser Act of 1933. The Employment Service is a federally funded but state-administered system, with offices operating throughout the country. It is primarily a labor exchange, attempting to match--without charge--the skills and interests of job applicants with openings listed by employers. The

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24. Abt Associates, "The Downriver Community Conference Economic Readjustment Activity Program: Impact Findings from the First Phase of Operations" (April 1983).

25. Congressional Budget Office, Dislocated Workers, pp. 27-28.

primary service provided to jobseekers is referral to listed job openings. Services to employers include job analysis, studies of turnover and absenteeism, and assistance in job restructuring, along with help in filling job openings. The Employment Service does nothing to develop the employability of job applicants, although it provides some aptitude testing and counseling and serves as a source of information and referral for employment and training programs and apprenticeship programs in which job applicants might usefully participate. Agencies make some efforts at job development, in which they encourage local employers to list more of their vacancies with the Service as well as soliciting placements for specific Employment Service applicants. 26/

The amount appropriated for the placement activities of the Employment Service--$824 million in 1983--is allocated among the states by a formula based on labor force size and the number of unemployed. Staff years funded under the Wagner-Peyser Act have not increased significantly since 1966 despite a large increase in the labor force over that time. 27/ Some additional funding is provided for services rendered to CETA prime sponsors, local welfare agencies, and others.

Despite its large scale of operation--17 million applications, 8 million job listings, and 6 million placements in 1981--the Employment Service has never been the dominant labor exchange in U.S. labor markets because most placements are achieved through the private efforts of jobseekers and employers. 28/ It is, however, an important placement resource for many disadvantaged workers. In 1980, minority workers accounted for 30 percent, and youth accounted for 31 percent, of all applicants. Women, the physically handicapped, migrant farm laborers, and other disadvantaged groups are also served in numbers disproportionate to their representation in the labor force. 29/ Much of the Employment Service's responsibility for disadvantaged workers, however, has been of a regulatory or enforcement nature, which has reduced the time and effort devoted to counseling and placement activities with resultant discontent about the overall effective-

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26. Employment and Training Report of the President, 1981, pp. 47-50.

27. See Youth Employment Act of 1979, Hearings, Ft. I, p. 381.

28. National Commission for Employment Policy, Seventh Annual Report (October 1981), p. 84; Employment and Training Report of the President, 1982, p. 48.

29. Employment and Training Report of the President, 1981, p. 48.

ness of the Service. 30/ Conflict between these supplementary responsibilities and basic labor exchange functions was reduced by amendments to the Wagner-Peyser Act included in the Job Training Partnership Act of 1982, which established separate funding provisions for the two kinds of activities.

SOCIAL SERVICE PROGRAMS

Social service programs serve a number of functions. Foremost among these is the provision of protective, rehabilitative, and community- and home-based services intended to prevent both the neglect and the unnecessary institutionalization of dependent persons--children, the aged, and the disabled. Secondary functions include counseling, referral, and advocacy services intended to ensure that eligible persons receive the benefits that are available for them.

These services are currently funded through a mix of private, federal, and state-local sources. It is estimated that private charities contribute 35 to 40 percent of total spending for social services, while public spending is 60 percent federal and 40 percent state-local. 31/

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30. In addition to its placement activities, the Employment Service has a number of other responsibilities under various laws, executive orders, and agreements with other agencies. Agencies are supposed to ensure that employers who use the Service abide by equal employment opportunity laws and federal labor regulations. Some beneficiaries of income transfer programs such as Unemployment Insurance, Aid to Families with Dependent Children, and food stamps are required to register for job placement with the Service. Employment Service offices are the certifying agents for employees eligible for the Targeted Jobs Tax Credit. They have a major recruiting role for the Job Corps and other youth programs. They are also responsible for certifying alien workers, for monitoring migrant farm housing, and for certifying eligibility for rural business and development loans. See National Commission for Employment Policy, Seventh Annual Report (October 1981), p. 85; and Youth Employment Act of 1979, Hearings, Pt. I, p. 78.

31. See Michael F. Gutowski and Jeffrey J. Koshel, "Social Services," Chapter 10 in John L. Palmer and Isabel V. Sawhill, ed., The Reagan Experiment (The Urban Institute, 1982), pp. 325-26.

The federal role is limited almost entirely to funding and technical support through grants to the state, local, and nonprofit agencies that provide services. To a large extent, federal dollars simply subsidize services that would be provided anyway, at some level, by nonfederal governments. Some services--such as Head Start, rehabilitation services, and developmental disabilities programs--would probably be greatly reduced or eliminated in the absence of federal funding, though.

Although federal support for social services dates back at least to 1912 and the formation of the Children's Bureau, the Public Welfare Amendments of 1962 initiated a period of rapid expansion in federal funding for social services, with provisions aimed in part at preventing welfare dependency--and thus ultimately reducing welfare costs--among the population wherever possible. As the result of this expansion, the ratio of federal spending for social services to spending for income security and health rose from less than 3 percent in the early 1960s to a peak of 6.2 percent in 1972. Since then, however, the growth of spending for income support and health entitlement programs has outstripped that for social service spending, so that the ratio fell to 2.3 percent by 1982. 32/

Currently, the largest federal program for social services is the Social Services Block Grant, which accounted for 42 percent of grants spending for social services in 1983. This program supports a broad set of services, including day care for children and dependent adults, homemaker and other in-home services, and family planning. Other more restrictive categorical programs support foster care and adoption services for homeless or abused children, social and nutrition programs for the elderly, rehabilitation programs for the disabled, and volunteer activities in low-income areas (see Table B-4).

Social Services Block Grant

This grant was created by the Omnibus Budget Reconciliation Act of 1981, which merged a similar but more restrictive block grant authorized by Title XX of the Social Security Act with two much smaller Title XX programs: grants for day care services, and for training state and local social service workers. Federal funds under the current block grant--equal to $2.7 billion in 1983--are allocated among the states solely on the basis of population.

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32. Gutowski and Koshel, p. 323.

TABLE B-4. GRANTS FOR SOCIAL SERVICE PROGRAMS, 1982 AND 1983 a/

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
Social Services Block Grant	2,400	2,675	Formula grant to states based on population	Generally children, the aged, and the disabled
Community Services Block Grant	366	384	Formula grant to states based on preexisting distribution of funds. Minimum 90 percent pass-through to local agencies	Principally persons in low-income areas
Head Start	912	912	Project grants to state, local, and nonprofit agencies. State allocation determined by a formula based on pre-school-age low-income population. Recipient cost-sharing (20 percent) required	Economically disadvantaged pre-school children
Child Welfare Programs:				
Title IV-B of the Social Security Act: Child Welfare Services	173	173	Mostly formula grants to states based on population and income. Recipient cost-sharing (25 percent) required	Any children or families in need of services

(Continued)

TABLE B-4. (Continued)

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
Title IV-E of the Social Security Act: Foster Care and Adoption Assistance	305	400	Entitlement for AFDC-eligible children. Recipient cost-sharing required, at the state AFDC rate	Welfare children in foster care
Runaway and Child Abuse Programs	27	38	Project grants to state, local, and nonprofit agencies. Recipient cost-sharing (10 percent) required for runaway programs	Abused, neglected, and runaway children
Older Americans Act: Social and Nutritional Services b/	636	672	Mostly formula grants to states based on elderly population. Recipient cost-sharing (15 percent) generally required	Persons aged 60 or more, especially those with the greatest economic or social needs
Rehabilitation Services	952	1,045	Mostly formula grants to states based on population and income. Recipient cost-sharing (20 percent) generally required	Persons with physical or mental disabilities that impede their employment

(Continued)

TABLE B-4. (Continued)

Program	Budget Authority a/ 1982 (millions of dollars)	Budget Authority a/ 1983 (millions of dollars)	Distribution Mechanism	Beneficiaries
Volunteer Programs (ACTION)	132	129	Project grants to state, local, and nonprofit agencies. Recipient cost-sharing (10 to 50 percent) generally required	Low-income and elderly persons
Developmental Disabilities Programs	59	61	Mostly formula grants to states based on population and income. Recipient cost-sharing (25 percent) generally required	Mentally retarded persons

SOURCE: Catalog of Federal Domestic Assistance.

a. Congressional Budget Office estimates. For some programs, budget numbers include small amounts not distributed as grants but used for associated federal activities.

b. Excludes Community Service Employment, which is shown in Table B-3.

Under the consolidated grant, there is no requirement that spending levels under the predecessor grants for day care and for training be maintained. In addition, federal requirements under the prior grants restricting eligibility for services to low-income individuals and requiring matching state-local funds were eliminated. The elimination of the matching requirement is not likely to have much effect on total service levels, however, since most states provided more than their required share.

Since federal funding for 1982 was about 7 percent below that required to maintain 1981 service levels, some states reduced their spending for day care and for training in an effort to maintain other services, particularly protective services for children and adults and community-based services for the elderly and disabled. In addition, they shifted costs to other federal programs wherever possible. For example, for welfare clients, day care costs were shifted to AFDC, and family planning and home health care costs were shifted to Medicaid. Evidence for the priority given to broad-based social service programs (over redistributive programs) is the decision by 20 states to transfer funds from the Low Income Energy Block Grant to the Social Services Block Grant under provisions contained in the Omnibus Budget Reconciliation Act. 33/

Although social services are often supported simply for humanitarian reasons, some services might be expected to yield positive results on a strict cost-benefit basis. Family planning services help to reduce the incidence of teenage pregnancies, for example, and reduce long-term welfare costs. 34/ Community- and home-based services for the elderly and the disabled might enable some individuals to remain in their own homes at less public expense than if they were institutionalized. If benefits of this sort are substantial, immediate savings from cutting spending for social service programs could be offset in later years by increased public assistance and health costs for both federal and nonfederal governments.

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33. See Gutowski and Koshel, pp. 316-17.

34. See Jacqueline Forrest, Albert Hermalin, and Stanley Henshaw, "The Impact of Family Planning Clinic Programs on Adolescent Pregnancy," Family Planning Perspectives, vol. 13, no. 3 (May/June 1984), pp. 109-16; and R. Wertheimer and K. Moore, "Teenage Childbearing: Public Sector Costs," Final Report to the Center for Population Research, Department of Health and Human Services (The Urban Institute, December 1982). See also Kristin A. Moore and Martha R. Burt, Private Crisis, Public Cost: Policy Perspectives on Teenage Childbearing (The Urban Institute, 1982).

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Community Services Block Grant

The Community Services Block Grant replaced programs run by the Community Services Administration (CSA) in 1982. Block grant funds with no matching requirement are distributed among the states based on the previous allocation of funds to states under the CSA, which gave project grants directly to community action agencies in largely urban, low-income areas. Some states indicate, however, that they intend to distribute funds more broadly among localities in the future since federal requirements for continued funding of previous recipients no longer apply beginning in 1983. 35/ It is uncertain how community action agencies will fare under the new block grant. Federal dollars may instead be channeled entirely through local government agencies.

Funds may be used for a variety of community-based services and for community economic development. In the past, community action agencies often served as sponsors for Head Start programs, and were the recipients of grants for a variety of other federal and state programs. Their major role was to draw together and coordinate the various federal, state, and local resources that could be used to improve the lot of the poor in the community. If funds are distributed to local agencies uniformly throughout the state in the future, though, this grant will probably become a general subsidy for social services, indistinguishable from the Social Services Block Grant.

Head Start

Head Start is an additional source of funding for compensatory services. It provides educational, nutritional, health, and social services to pre-school children from poor families in an effort to reduce disparities in development between disadvantaged children and others, so that poor children might begin their formal education on a more equal basis. Most programs operate 4 to 6 hours a day, for 8 to 12 months a year. Head Start programs spent $2,311 per child, on average, in 1982, but sponsors typically made extensive use of other federal programs--especially nutrition subsidies, Medicaid, and public service employment--in providing services as well. 36/

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35. Nathan, et. al., p. 343.

36. The use of public service employees has been greatly reduced by the elimination of public service employment in most employment assistance programs (CETA and its successor, JTPA). Some public service employment continues, however, for older workers through the Community Service Employment (CSE) program under the Older Americans Act.

Head Start funds are apportioned among the states by a formula based on each state's relative number of poor children. Project grants from a state's allocation are then provided by the federal government to eligible local organizations within the state--including community action agencies, schools, and churches. Local sponsors are required to provide at least 20 percent of program expenses. Some provide more than this, but the bulk of local contributions is in-kind--volunteer workers and donations of space and equipment. Federal dollars are nearly 100 percent of cash support. Head Start programs, like compensatory services under Chapter I of the ECIA, would probably be greatly reduced or eliminated in the absence of federal funding.

Both the General Accounting Office and the Department of Health and Human Services have reviewed existing evaluation studies of Head Start, and have concluded that full-year (but not summer) programs are generally effective in meeting their goals--gains in the cognitive skills, social development, and health of Head Start children relative to similar children who do not participate in the program. 37/ Although it is not known how long the relative gains for Head Start children are sustained once the children enter regular school programs, there is evidence from some high-quality demonstration projects providing services similar to those available to Head Start children that the gains are long-lasting. 38/

Child Welfare Programs

The principal source of federal funding specifically for child welfare services is Title IV of the Social Security Act. 39/ Funds appropriated under Title IV-B are distributed to the states by a formula based on the size of the

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37. See General Accounting Office, "Head Start: An Effective Program but the Fund Distribution Formula Needs Revision and Management Control Needs Improvement," Report No. HRD-81-83, July 23, 1981; Department of Health, Education and Welfare, "A Review of Head Start Research since 1969, and An Annotated Bibliography," HEW Publication No. OHD-77-31102; and Congressional Research Service, "The Head Start Program: History, Legislation, Issues, and Funding: 1964-82," Report No. 82-93 EPW, May 10, 1982.

38. Center for the Study of Public Policies for Young Children, High Scope Educational Research Foundation, "High Quality Early Childhood Education Programs."

39. Child welfare services may also be funded under the Social Services Block Grant.

under-18 population and per capita income; these funds may be used for foster care maintenance, family counseling, adoption, and child protective services, regardless of family income. States spend far more than the required 25 percent match, so that less than 10 percent of services are federally funded.

Funds under Title IV-E, by contrast, are provided to the states on an entitlement basis for foster care and adoption assistance for abused or neglected children from AFDC families. Adoption assistance may include cash payments to the adoptive family and the continuation of Medicaid benefits to the adopted child. The required state share is the same as the state's AFDC and Medicaid share, which averages around 45 percent. Before the Adoption Assistance and Child Welfare Act of 1980, states were reimbursed on an entitlement basis for their foster care expenses for AFDC children, but no federal assistance was provided to adoptive parents. The intent of the Adoption Assistance and Child Welfare Act was to increase incentives for permanent adoption of children in foster care when family reunification was not possible. Since the act was not fully implemented until the beginning of fiscal year 1983, there is no evidence as to how effectively the new program provisions will meet these objectives. 40/

Services for the Elderly

The largest federal program of social services for the elderly is the Older Americans Act (OAA) of 1965, which funds nutrition programs and a range of community- and home-based services (as well as the CSE program, discussed earlier under employment assistance programs). The elderly are also major recipients of (often similar) services under the Social Services Block Grant, the Community Services Block Grant, and federally supported volunteer programs.

The services available under these programs have two principal purposes: to reduce the social isolation of the elderly; and to provide the nutritional, health, homemaker, and transportation services necessary to enable elderly persons who are only moderately disabled to continue living in their own homes. Funds under the Older Americans Act (excluding the CSE program) are allocated among the states on the basis of each state's population aged 60 or over. State and area agencies provide about 50 percent, on average, of the funding for nutrition and social service programs for the elderly, although their required share under the OAA is only 15 percent.

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40. Jan Fowler, "Federal Child Welfare Programs: Titles IV-B and IV-E of the Social Security Act," Congressional Research Service, Education and Public Welfare Division, January 1983.

The OAA originally served as a catalyst for generating more services directed toward the needs of the elderly, but now services for the elderly receive considerable independent support at the local level. Still, only a small proportion of older Americans with physical limitations who are not institutionalized receive federally supported social services of any type. Further, the decentralized and unrestrictive nature of current programs has led to a distribution of benefits that is not necessarily targeted on those most in need. Elderly persons with strong community ties and an awareness of the existence of programs are more likely to be participants than are the socially or physically isolated. In addition, the services that are received by the disabled are not always comprehensive enough to prevent institutionalization. 41/

Rehabilitation Services

The vocational rehabilitation program now authorized under Title I of the Rehabilitation Act of 1973 has been a federal categorical program since 1920. Basic grants to the states are distributed to state agencies by formula, based on population and per capita income. States are required to provide matching funds of 20 percent, and apparently little overmatching occurs. 42/ Federal support for state rehabilitation services has been declining in real terms since 1975, and the number of new cases accepted has been dropping correspondingly, indicating that states have not increased their support to maintain services.

The federal government will reimburse state agencies for the cost of rehabilitation services for clients receiving Social Security Disability Insurance or Supplemental Security Income, if successful rehabilitation is demonstrated by a return to gainful employment for a period of not less than nine months, subject to the stipulation that the reimbursement for each case must not exceed savings (from reduced benefit payments) to the trust fund.

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41. There is a bias toward institutionalization in the major federal health care programs, since coverage for home-based services under Medicare and Medicaid has been available only since 1981, and is subject to severe constraints. Currently, about 2 percent of payments under Medicare and Medicaid are for home-based care.

42. In 1981, the actual state share was about 24 percent. In 1982, reported figures show a state share of 26 percent, but this included federal reimbursements through SSDI and SSI, which are not appropriately counted as matching state funds.

Studies by the Rehabilitation Services Administration (RSA) indicate that its programs, unlike some other social service programs, create significant public savings by putting handicapped persons back to work. The RSA estimates that discounted lifetime earnings for rehabilitated persons improve, on average, by $10 to $11 for every dollar spent on services for all clients whose cases are closed in a given year (with or without successful rehabilitation). In 1980, it estimates that the first-year improvement in personal earnings yielded public benefits from rehabilitation--due to increased tax collections and reduced public assistance--of $280 million. Of this, an estimated $213 million were benefits to the federal government. At this rate, the total costs of rehabilitation for cases closed in 1980 ($1.1 billion) would be recovered by federal and state governments combined within 4 years, and the federal costs would be recovered by the federal government in that period as well. 43/

Based on these estimates, reductions in federal funding for vocational rehabilitation--if the resultant reductions in the number of persons served are not offset by increased rehabilitation through private or charitable organizations--are likely to increase rather than decrease federal budget deficits in the long run. 44/

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43. Discounting would lengthen the period required for cost recovery, but--at current interest rates--it would not eliminate the net public benefit from rehabilitation. See Rehabilitation Services Administration, Division of Program Administration, Basic State Grants Branch, "In-House Benefit/Cost Ratios: State-Federal Program of Vocational Rehabilitation," April 1982.

44. This assumes that all increased earnings are the result of rehabilitation services. One study estimates that in 1977 about 25 percent of those counted as rehabilitated would have recovered without rehabilitation services. This would reduce the public benefits attributable to rehabilitation, thereby lengthening the period necessary for recovery of public costs through increased tax revenues and reduced public assistance. The increasing emphasis in recent years on serving the severely disabled--defined as those with work potential who would not recover without rehabilitation services--has probably reduced the proportion of those served who would have recovered without services, however. See Leo A. McManus, "Evaluation of Disability Insurance Savings Due to Beneficiary Rehabilitation," Social Security Bulletin (February 1981), vol. 44, no. 2, p. 20.

Volunteer Programs

Volunteer activities are a local resource that may be useful in combatting the effects of poverty, and grants from ACTION--a federal agency supporting volunteer programs--are available to local agencies on a project basis for the administrative and technical expenses associated with neighborhood volunteer activities. The elderly and the handicapped are major beneficiaries of these volunteer activities, since programs such as Foster Grandparents, the Retired Senior Volunteer Program (RSVP), and Senior Companions help to alleviate the social isolation of the able-bodied who serve as volunteers, while they provide household services and long-term care for those who are not able-bodied. Some federal funding may play an important role here as seed money, although at higher levels federal dollars may instead supplant private charity by reducing the vigor with which charities solicit private contributions.

Developmental Disabilities Programs

The federal government provides formula grants to states for services to persons with developmental disabilities--defined as severe, chronic, and seriously limiting disabilities that began prior to age 22. To qualify for federal funds, states must have a protection and advocacy system intended to ensure that the legal and human rights of mentally retarded individuals are protected. A state match of 25 percent is required, and few states provide much more than this. Similar services can be provided under the Social Services Block Grant. Advocates for the retarded contend that their needs are shortchanged when they must compete with other groups for services, however, because retarded persons tend to be difficult and expensive to serve and because their numbers are so small compared to other target groups.

APPENDIX C. BACKGROUND INFORMATION ON INCOME SECURITY AND HEALTH PROGRAMS

This appendix provides detail on federal income security and health programs. Like Chapter VI, it concentrates on public assistance programs, most of which are funded jointly by the states and the federal government. The first section of the appendix describes income security programs while the second discusses health care programs. 1/

INCOME SECURITY PROGRAMS

Over one-third of the federal budget in 1982 was devoted to income security programs. The largest of these are Social Security and other retirement programs, but since those programs are generally accepted as federal responsibilities they are not examined here. The income security programs discussed are means-tested and are jointly operated by the federal government and state or local governments (see Table C-1).

Aid to Families with Dependent Children (AFDC)

The AFDC program provides grants to states for income assistance to low-income families with children. AFDC is an entitlement, which means that all applicants who are eligible and who apply receive benefits. Eligibility is jointly determined by the federal government and each state. The federal government stipulates the category of people eligible--generally single-parent families with children--and states determine the income level at which such households may receive assistance and the amount of assistance they receive. 2/ The federal government pays a share of program

1. The budget numbers shown in this appendix are generally outlays, rather than budget authority as was shown in previous appendixes. Many of the programs discussed here are entitlements for which funds are usually appropriated as needed. Outlay estimates for the non-entitlement programs considered here have also been given, where possible, to allow consistent comparisons across programs.

2. The federal government allows, but does not require, two-parent families with an unemployed parent to be covered, at state option.

TABLE C-1. FEDERAL OUTLAYS FOR INCOME SECURITY PROGRAMS, 1982 AND 1983 (In millions of dollars)

Program	1982 Actual	1983 Estimated
Aid to Families with Dependent Children a/	7,990	8,153
Supplemental Security Income	7,677	8,870
Food Stamps	11,014	12,539
Housing Assistance b/	7,888	9,356
Child Nutrition c/	3,950	4,421
Others d/	3,899	3,797

SOURCE: Congressional Budget Office.

a. Includes Child Support Enforcement.

b. Includes the public housing program and the lower income housing assistance program (Section 8 of the Housing Act of 1937, as amended).

c. Includes National School Lunch Program, Special Supplemental Food Program for Women, Infants, and Children (WIC), National School Breakfast Program, Childcare Feeding Program, Summer Feeding Program, Special Milk Program, and other small programs.

d. Includes Low Income Home Energy Assistance (LIHEA), Earned Income Tax Credit, and Refugee Assistance.

costs in each state, based on the state's per capita income. The federal share varies from 50 to 78 percent and currently averages about 55 percent. Estimated federal outlays in 1983 are $8.2 billion.

Since states determine benefit levels for the AFDC program, families with similar characteristics and similar incomes may receive widely varying amounts of assistance in different states. Each state sets payment standards, which are the maximum benefits paid to families of varying sizes that have no other source of income. Payment standards (in the continental United States) vary from a low of $96 per month for a family of three in Mississippi to a high of $513 per month for a similar family in Connecticut. Benefits are calculated as the difference between the family's adjusted income and the state's payment standard.

Program History. AFDC was established in 1935 under the Social Security Act to assist families with an absent or disabled parent. Since then, several important changes in eligibility and work rules have been made.

The major change in program eligibility came in 1961, when states were given the option of providing benefits to two-parent families whose primary wage earner is unemployed or partially employed. To date, 20 states and the District of Columbia have exercised this option. Other eligibility changes, made as part of the Omnibus Budget Reconciliation Act of 1981, include ending benefits for children beyond high school age and for pregnant women without children until the third trimester of their pregnancies.

Several changes designed to increase recipients' work incentives have also been enacted. In 1967, a rule was established allowing the first $30 per month in earnings to be disregarded in computing AFDC payments, as well as one-third of each recipient's earnings above that threshold. Also beginning in 1967, the Congress required states to deny AFDC payments to adults who refused to accept employment or training opportunities and authorized federal grants to provide such opportunities through the work incentive (WIN) program. In 1971, registration for WIN was made mandatory for all able-bodied AFDC recipients when their youngest child reached the age of six. In 1981, however, the Omnibus Budget Reconciliation Act reversed the trend toward stronger work incentives by limiting to four months the period during which earnings are disregarded, and by reducing benefit levels for working parents through changes in the treatment of work expense deductions. At the same time, an attempt was made to tighten work requirements by authorizing states to establish community work programs ("workfare") in which recipients would be required to work on public projects in exchange for their benefits.

Recipiency and Benefits. The number of AFDC recipients grew from 3 million in 1960 to over 11 million in the late 1970s and then--largely as a result of changes implemented in the 1981 budget reconciliation

act--declined to 10.4 million in 1982. Since 1961, the fraction of all families receiving aid that are two-parent families with an unemployed primary wage earner has ranged from about 4 percent to its current level of about 7 percent.

Benefit increases under AFDC have varied widely over time and among states. Average benefits per person increased by about 36 percent in real terms between 1960 and 1970. From 1970 to 1980, benefits on average rose by 5 percent in real terms, but most of this increase occurred in just a few states, while benefits in most states failed to keep pace with inflation. Between 1980 and 1982, average benefits fell 11 percent in real terms.

The costs of the AFDC program have risen in response to both increases in program participation and increases in benefits. Federal spending for AFDC totaled $667 million in 1960 and increased to $2.3 billion in 1970. Federal outlays rose in real terms through the 1970s by an average annual rate of under 4 percent. Between 1980 and 1982, real outlays grew by under 1 percent, to $8.0 billion in 1982.

Supplemental Security Income (SSI)

SSI is an entitlement program that provides income support for elderly and disabled persons. Unlike in AFDC, the federal government determines SSI eligibility standards, sets the basic program benefits, and pays the full costs of providing basic assistance. States may then supplement these benefits. Persons are categorically eligible for SSI if they are either 65 years of age or older or are disabled, with benefit levels determined by income. Federal payment standards for recipients with no other income are currently set at $304 for individuals and at $456 a month for couples. The benefits provided are the difference between the payment standard and a recipient's adjusted income. Estimated federal outlays in 1983 are $8.9 billion.

Although federal SSI benefits are uniform among states, variations in states' supplemental benefits mean that similar households may receive different benefit levels from state to state, although the variation is not as great as in the AFDC program. In establishing the SSI program in 1972, the Congress required states that had previously provided higher benefits to any group than would be provided under SSI to maintain the previous level of support. In 1981, 7 states provided only required supplemental benefits; 24 provided supplementation to selected categories of recipients; and 17 states and the District of Columbia supplemented federal SSI payments to all or nearly all recipients. State supplements range up to $167 a month for individuals and up to $412 for couples, though most are below these levels.

Program History. SSI was created under the 1972 amendments to the Social Security Act and took effect in January 1974. It replaced federal grants to states under the earlier Old Age Assistance (OAA), Aid to the Blind (AB), and Aid to the Permanently and Totally Disabled (APTD) programs.

Few major changes have been made in the SSI program since its enactment. In 1976, states were required to pass on the cost-of-living adjustments made in federal SSI benefit levels each year, thus preventing them from reducing their required hold-harmless payments by the amount of the federal increase. The Social Security Disability Amendments of 1980 modified eligibility requirements and the benefit structure to provide greater work incentives for the disabled. In 1981 and 1982, minor modifications were made in the benefit calculation rules, lowering average benefit levels slightly. Additional changes in 1983 that increased program benefits for most recipients, however, more than offset these reductions.

Recipiency and Benefits. The number of SSI beneficiaries in December 1974 was 4 million, up from the 3.1 million receiving aid under the programs that preceded SSI. The program peaked at 4.3 million recipients in 1976 and since then has slowly declined to 4.0 million in 1982. The number may rise in the near term, however, because in 1983 the Congress passed legislation requiring that the Social Security Administration notify certain Social Security recipients that they may be eligible for SSI. The composition of SSI beneficiaries has shifted over time, with the number who are disabled rising from 39 percent in 1974 to 57 percent in 1982, the share who are elderly declining from 58 percent in 1974 to 41 percent in 1982, and the proportion who are blind remaining nearly constant at 2 percent. 3/

Benefits under the federal portion of the SSI program are increased each year by the same cost-of-living adjustments used in Social Security retirement and disability programs. Thus, the delay in the annual cost-of-living increase authorized by the Social Security Amendments of 1983 will reduce benefits by $400 million over the next three years. The amendments also increased SSI benefits by up to $20 a month for single recipients and by up to $30 a month for married recipients. These increases will more than offset the average reduction caused by delay in the cost-of-living adjustment, resulting in a net increase in SSI outlays of about $1.4 billion over the 1982-1985 period.

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3. These percentages probably understate somewhat the share of SSI recipients who are elderly, because disabled recipients are classified as such even after they reach the age of 65.

The federal government currently provides about 75 percent of SSI benefits, at a cost of $7.7 billion in 1982. The states' contributions to SSI vary widely. For states that provide only the required hold-harmless benefits, costs have fallen dramatically, particularly when compared with the costs of the pre-SSI programs. States providing limited supplementation have also experienced declining costs, at least in real terms, as caseloads have fallen. For states providing nearly universal supplementation, costs have generally risen as a result of growth in both caseloads and payment standards.

Food Stamps

The Food Stamp program--an entitlement that is federally funded but administered by states and localities--provides coupons to low-income persons and families with which they may purchase food. It is the only federal income security program with no categorical limitations; eligibility is based on income. The federal government pays all of the benefit costs and about half of state and local administrative expenses.

Both benefit levels and eligibility criteria are federally determined and are uniform among states. 4/ Benefits are based on the Thrifty Food Plan, a low-cost but nutritionally adequate diet. For a family with no income, benefits equal 99 percent of the Thrifty Food Plan amount--$199 per month for a family of three, for example. Since families are assumed to spend about 30 percent of their income on food, benefits are reduced by 30 cents for each dollar of adjusted income. Cash transfer payments like AFDC and SSI benefits are counted as income in determining a family's food stamp benefits, and, since benefit levels in those programs vary among states, federal spending on food stamps also varies considerably among states. In states with high payment levels for AFDC and SSI, average food stamp benefits tend to be fairly low, while in low cash-benefit states, food stamp benefits are relatively high. Estimated federal outlays in 1983 are $12.5 billion.

Program History. In the early years of the Food Stamp program, states played an important role in determining who benefited. Following a set of pilot programs initiated by an executive order in 1961, the Food Stamp Act of 1964 established a state-oriented, but nationwide, program in which states could participate. The federal government, which financed the entire program save a share of administrative costs, set the benefit levels. States decided the geographic coverage of the program--with the option of

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4. Benefit levels are higher in Alaska and Hawaii.

providing benefits only in some areas--and the criteria for determining eligibility. Eligible households were required to pay a portion of their incomes in order to obtain their allotment of stamps, a provision commonly referred to as the "purchase requirement."

Over time, the federal government assumed a larger role in determining eligibility and benefit levels. The 1971 Food Stamp Amendments replaced varying state eligibility standards with uniform federal standards, and indexed allotments to the rate of food price inflation. Another set of amendments, enacted in 1973, provided for nationwide operation of the program in all states and localities, expanded eligibility, and introduced semiannual indexing of allotments. The Food Stamp Act of 1977 eliminated the purchase requirement and replaced it with the reduction of benefits by 30 cents for each dollar of income. The new act also simplified the deductions from income and restricted eligibility and benefits somewhat, though some benefits lost to elderly and disabled recipients by these changes were restored by amendments in 1979. Further, small changes were made by amendments in 1980, including provisions intended to reduce error and fraud.

In 1981 and 1982, Congress made several changes that further reduced eligibility and benefits. For example, the Omnibus Budget Reconciliation Act and the Agriculture and Food Act of 1981 eliminated inflation indexing of benefits for 1982, postponed certain other inflation-related adjustments in later years, and replaced the Food Stamp program in Puerto Rico with a block grant. In addition, the incentives for states to lower their rates of erroneous payments were replaced by stronger sanctions that reduce federal funding for administrative costs in states that fail to achieve specified annual reductions in error rates.

Recipiency and Benefits. Participation in the Food Stamp program in 1962 averaged 143,000 recipients per month and steadily climbed to 4.3 million in 1970 as the number of participating localities increased. Continuing geographic expansion, adoption of uniform federal eligibility standards, the recession in 1974-1975, and--most important--the transfer of participants in the Food Distribution Program to food stamps caused the number of recipients to quadruple between 1970 and 1975, to about 17 million. Average monthly participation declined steadily from the recession peak of 19.3 million in May 1975 to a low of 15.2 million in September 1978 as unemployment dropped. With the elimination of the purchase requirement and other changes in 1979 and with the economic downturn of 1980, participation again increased to a peak of about 23 million in March 1981 and declined slowly afterward. The legislative changes in 1981 and 1982 eliminated the eligibility of about 4 percent of program recipients, while the

recent recession increased participation. With the decline in unemployment, monthly participation is currently averaging roughly 23 million people.

Monthly food stamp benefits--currently averaging about $43 per person--are a function of the level of the Thrifty Food Plan, price inflation, household size and composition, and the cash incomes of participants from earnings and government transfers. Average monthly benefits increased in real terms about 50 percent from 1970 through 1975 and have increased another 80 percent since 1975, although the rate of increase has been much lower in recent years.

Federal outlays for food stamps totaled almost $37 million in 1965. With growing levels of participation and benefits, outlays increased to $577 million in 1970 and to $4.6 billion in 1975. Outlays increased more slowly after 1975, reaching $9.1 billion in 1980. Legislative changes in 1981 and 1982 are expected to reduce outlays for the 1982-1985 period by about 13 percent relative to what they would have been under previous law, mostly by delaying benefit increases. Program funding totaled $11.0 billion in 1982.

Housing Assistance

The federal government provides direct housing assistance to lower-income households through a variety of programs, the largest being the public housing program and the housing assistance payments program (commonly called the Section 8 program, after the section of the Housing Act of 1937, as amended, that authorized it). 5/ Unlike other income security programs in this section, housing programs are not entitlements, and therefore not all eligible households who apply receive assistance.

Through the public housing program, the federal government finances the construction costs of rental housing projects owned and operated by local public housing authorities (PHAs) and also pays a portion of the operating expenses associated with these projects. The units are then rented to low-income households who pay a fixed share of their income toward their shelter costs. Through the Section 8 program, the federal government enables eligible households to live in privately-owned housing in either existing, recently rehabilitated, or newly built structures of their own

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5. The federal government also provides housing assistance to middle- and upper-income households through the tax system by allowing the deduction of interest payments on mortgages and of property taxes paid to state and local governments. The cost of this aid was nearly four times the cost of direct housing assistance programs in 1982.

choosing. The federal government pays the difference between a fixed portion of a household's adjusted income and the unit's rent, not to exceed a federally established maximum level.

The federal role in these housing programs includes determining the amount of assistance to be made available each year, the programs through which it is to be made available, and the eligibility criteria to be used in identifying recipients. Local PHAs then allocate available assistance among eligible households and, in the case of the public housing program, operate housing projects. The costs of housing assistance not covered by tenant rents are generally borne by the federal government, though localities contribute by accepting payments in lieu of taxes on public housing projects. Estimated federal outlays in 1983 are $9.4 billion (see Table C-2).

TABLE C-2. FEDERAL OUTLAYS FOR HOUSING ASSISTANCE PROGRAMS, 1982 AND 1983 (In millions of dollars)

Program	1982 Actual	1983 Estimated
Public Housing	2,574	3,312
Housing Assistance Payments a/	4,085	4,880
Other b/	1,229	1,164
Total	7,888	9,356

SOURCE: Congressional Budget Office.

a. Section 8 of the Housing Act of 1937, as amended.

b. Includes rental housing assistance, rent supplements, homeownership assistance, and college housing grants.

Program History. Federal housing assistance has served several goals that have received varying emphasis over time, including stimulating economic activity through new construction, revitalizing low-income neighborhoods, and assisting low-income households. Federal policy has generally

shifted from public to private ownership of housing, from improving the quality of housing to lowering the costs paid by low-income households, and from serving households of modest means to aiding very poor households.

The public housing program is the oldest federal housing assistance program, established in 1937 as a means of stimulating economic activity following the Depression. 6/ Through it, local PHAs were able to construct new rental housing, often as part of efforts to restore declining neighborhoods, thus increasing the supply of decent-quality housing. Tenants of public housing were generally experiencing temporary hardship, and the program was not designed to serve very poor households who could not pay the required rent levels. Federal subsidies covered only debt service on initial construction costs.

In the postwar period, public housing tenants grew relatively poorer because of shifting federal policies and widening opportunities for middle-income households. As the rents paid by tenants fell increasingly short of the levels required to pay operating costs, in 1969 the federal government limited tenant rents to 25 percent of adjusted household income and instituted subsidies for operating expenses on behalf of all tenants. These subsidies have grown to nearly half of public housing operating costs in 1982.

From 1937 until 1961, the public housing program was the sole mechanism for federal housing assistance, and during that period over 460,000 units were made available. Beginning in the 1960s, additional forms of federal assistance relying on the private market were developed, including rent supplements to cover the difference between the share of household income designated for rent and actual rents in privately owned projects, and reduced-interest mortgages for multifamily projects that resulted in lower rents charged to low-income households. By 1973, total public housing units available numbered just over one million, while 721,000 units were provided through other federal programs.

In response to growing concern about the costs and effectiveness of these programs, the Congress in 1974 instituted the Section 8 program, which provides supplementary rental payments to private landlords on behalf of low-income households. Although program emphasis was initially placed on improving the housing stock through new construction and substantial rehabilitation--in response to the priorities of local PHAs--the rising costs of this approach have recently dictated a shift toward reliance on the existing stock of private housing. Of Section 8 assistance commitments

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6. For further detail on the public housing program, see Congressional Budget Office, Federal Subsidies for Public Housing: Issues and Options (1983).

made through 1981, 45 percent were for newly constructed or substantially rehabilitated units; in 1982, only 20 percent of commitments were for such units.

The major recent change in housing assistance programs was made under the Omnibus Budget Reconciliation Act of 1981, which increased the rents paid by assisted households from 25 to 30 percent of adjusted income, to be phased in over a five-year period. Further, the act required that 95 percent of new housing commitments be directed to households with incomes below 50 percent of area median income, with no more than 5 percent provided to households with adjusted incomes between 50 and 80 percent of the area median.

Recipiency and Benefits. In 1982, 4.0 million federal rental housing assistance commitments were outstanding, while 18.6 million renter households were eligible for such aid on the basis of their incomes. 7/ Of the total, 1.2 million commitments were for the public housing program, while 1.6 million were through the Section 8 program. Outlays for housing assistance programs have climbed from $2.1 billion in 1975 to $7.9 billion in 1982. Of the 1982 total, $2.6 billion was for the public housing program and $4.1 billion for the Section 8 program.

Child Nutrition Programs

Child nutrition programs include the National School Lunch Program, the Special Supplemental Food Program for Women, Infants, and Children (WIC), the National School Breakfast program, the Child Care Feeding program, the Summer Feeding program, the Special Milk program, and several others. They provide cash and commodities to states for distribution to individuals, schools, and child care programs. The WIC program provides food supplements to low-income women and young children, while other programs subsidize meals for children in schools, child care facilities, and other institutions.

Federal aid amounts to about half of total spending on child nutrition programs, with the remainder coming from states and local institutions and from families. Typically, the programs are locally operated and administered. The federal government assists participating institutions by providing a mix of commodities and cash reimbursements based on the number of meals served, using nationwide formulas to determine the amount of

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7. See Congressional Budget Office, Federal Housing Assistance: Alternative Approaches (May 1982), p. 28.

subsidy. Total estimated obligations in 1983 are $4.4 billion (see Table C-3). In addition, roughly $0.4 billion in commodities will be provided.

In most programs, all meals served receive some federal subsidy, regardless of the family income of the participant, as long as federal nutritional criteria are met. Substantially higher subsidies, however, are provided for meals served free or at a reduced price to children from low-income families. Income eligibility for free meals is 130 percent of OMB's income poverty guidelines and 185 percent of these guidelines for reduced-price meals. 8/

Program History. Federal aid for child nutrition began during the Depression with the purchase and distribution of surplus agricultural commodities to school lunch programs, and has expanded since then to encompass a wide range of programs. Cash subsidies to school lunch programs began in 1943 and were permanently authorized by the Child Nutrition Act of 1946. The school lunch program remained the only federal child nutrition effort until enactment of the Special Milk Program in 1957. A period of expansion in federal child nutrition programs began with the Child Nutrition Act of 1966, which established the National School Breakfast Program. The National School Lunch Amendments of 1968--which authorized the Child Care Food Program--extended federal nutrition assistance from schools to other institutions serving children by authorizing a summer meal program and a year-round food service program for children in day-care facilities. In 1969, the Department of Agriculture began what was eventually called the Commodity Supplemental Food Program, which provided free commodities to low-income, nutritionally at-risk, pregnant women, new mothers, and young children. The Special Supplemental Food Program for Women, Infants, and Children (WIC), was created in 1972 to serve the same groups through federal grants to state agencies.

The Omnibus Budget Reconciliation Acts of 1980 and 1981 lowered federal subsidy rates in the school lunch and related programs and restricted income eligibility for free and reduced-price meals. In addition, eligibility limits were lowered for WIC, and the Special Milk Program was substantially reduced.

Recipiency and Benefits. Increased participation in child nutrition programs during the 1970s was largely the result of new programs and new

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8. For a family of three in the continental United States and the District of Columbia between July 1983 and June 1984 the limit for free meals is $10,686 per year and $15,207 for reduced-price meals. The limits are higher in Alaska and Hawaii.

TABLE C-3. FEDERAL OBLIGATIONS FOR CHILD NUTRITION PROGRAMS, 1982 AND 1983 (In millions of dollars)

Program	1982 Actual	1983 Estimated
National School Lunch Program	2,134	2,350
Supplemental Food Program for Women, Infants and Children (WIC) a/	929	1,194
National School Breakfast Program	319	335
Childcare Feeding Program	290	344
Summer Feeding Program	89	94
State Administration	45	47
Special Milk Program	20	20
Other b/	8	8
Total	3,834	4,392

SOURCE: Congressional Budget Office.

NOTE: Because of limited data, this table reports obligations and is not, therefore, consistent with funding reported for child nutrition programs in Table C-1.

a. Includes Commodity Supplemental Feeding Program.

b. Includes funding for nutrition education and training, as well as special studies.

national eligibility standards that included higher income eligibility limits for free and reduced-price meals. Overall, the number of meals served in the school meal and child care programs increased by half to 5.4 billion in 1980 with most of the increase occurring in programs other than the school

lunch program. The school lunch program--the largest of the child nutrition programs--served 4.4 billion meals to 27 million children in 1980, an increase of one-fifth from 1970. Most of the increase in the school lunch program occurred in the free and reduced-price categories where participation increased 150 percent during the decade. The creation of the WIC program in 1974 also increased participation in nutrition programs, adding about 88,000 in 1974 and nearly 2 million in 1980. The budget reconciliation acts of 1980 and 1981 reversed the trend of growing participation in school and child care nutrition programs; in the school lunch program, for example, participation declined from 27 million to 23 million between 1980 and 1982, although these acts had little effect on WIC participation.

Because of these increases in participation, higher federal reimbursement rates, and the creation of WIC, federal expenditures increased from $0.7 billion in 1970 to $4.6 billion in 1980. Much of the growth occurred in the meal categories with highest federal subsidies and in the entirely federally funded WIC program. As a result, the federal share of total child nutrition spending increased from less than a third in 1970 to a half in 1980. Because of cutbacks enacted in 1980 and 1981, outlays for child nutrition fell from $4.3 billion in 1980 to $4.0 billion in 1982. Expenditures for programs other than WIC declined from $3.5 billion to $3.0 billion, while WIC increased from $0.7 billion to $0.9 billion.

Other Income Security Programs

In addition to the major public assistance programs discussed above, a number of smaller programs provide assistance to low-income families and individuals for specific purposes (see Table C-4). The largest of these is the Low Income Energy Assistance program (LIEA), which provides funds to states to aid individuals with high fuel bills, energy related emergencies, or weatherization projects. The assistance may be any combination of direct payments to individuals, vendor payments, vouchers, tax credits, or other forms of aid, and state programs vary widely in types of aid, eligibility criteria, and participation rates. In 1982, about two-thirds of energy assistance funds were used for heating assistance, and the average benefit provided for this purpose was $182. In all, between 8 and 9 million assistance grants were made. The program is entirely federally funded, but is operated by the states, which have considerable discretion in the allocation of funds.

Other income security programs that provide some aid to low-income households include the earned income tax credit and the Refugee Assistance program. The first of these is a refundable credit available to those with earnings below $10,000 and little other income, and the second provides grants to states to aid needy refugees and immigrants.

TABLE C-4. FEDERAL OUTLAYS FOR OTHER INCOME SECURITY PROGRAMS, 1982 AND 1983 (In millions of dollars)

Programs	1982 Actual	1983 Estimated
Refugee and Entrant Assistance	1,011	632
Low Income Energy Assistance	1,687	1,960
Earned Income Tax Credit	1,201	1,205
Total	3,899	3,797

SOURCE: Congressional Budget Office.

HEALTH PROGRAMS

The major federal health care programs are Medicare--for elderly and disabled persons who are eligible for Social Security--and Medicaid, which makes payments to providers of medical services on behalf of public assistance recipients and other medically needy persons. In addition, the federal government funds a number of much smaller grant programs for health care that support community health centers, family planning services, migrant health services, and black lung clinics, among other things (see Table C-5). As in Chapter VI, Medicare is not discussed here, since it is not an intergovernmental program.

Medicaid

Medicaid is an entitlement program, jointly operated and financed by the federal and state governments, that provides payments for medical services to low-income persons. The federal government designates eligibility for all recipients of AFDC and SSI, who account for about three-quarters of all Medicaid recipients, and states may at their option include other

TABLE C-5. FEDERAL OUTLAYS FOR SELECTED HEALTH CARE PROGRAMS, 1982 AND 1983 (In millions of dollars)

Program	1982 Actual	1983 Estimated
Medicaid	17,391	19,472
Health Care Grants a/	1,334	1,558

SOURCE: Congressional Budget Office

a. Appropriations, not outlays. Includes Preventive Health Care Block Grant, Substance Abuse and Mental Health Block Grant, Maternal and Child Health Block Grant, Primary Care Block Grant, Family Planning Services, Migrant Health Services, and Black Lung Clinics.

groups. 9/ Since the income cutoffs for SSI and AFDC eligibility differ across states, eligibility for Medicaid also varies.

The major supplemental coverage that states have elected to provide is for the "medically needy," who account for about 13 percent of current Medicaid recipients. Thirty states now have programs for the medically needy, and eligibility requirements under them vary considerably. In general, however, recipients under these programs have medical expenditures that are high relative to their incomes and meet the categorical eligibility requirements, except for income level, for either AFDC or SSI. States may also choose to cover people who meet some, but not all, of the categorical eligibility criteria for AFDC or SSI.

States pay a fixed share of total Medicaid expenditures, with the percentage in each state depending on the state's per capita income. The formula used to determine a state's share of costs is generally the same for Medicaid as for AFDC. The federal share of Medicaid expenditures varies among states from 50 to 78 percent, and averages about 55 percent. States

9. States have the option of limiting Medicaid coverage for SSI recipients by requiring them to meet any more restrictive eligibility criteria in effect before the implementation of SSI.

are required to provide certain services, and may provide additional services at their option. Somewhat more than half of total federal expenditures go for required services, although much of the remainder is spent on services that may provide lower-cost substitutes for some mandatory services, such as intermediate care facilities. Estimated federal outlays in 1983 are $19.5 billion.

Program History. Federal matching payments for medical services to recipients of federally supported public assistance programs were first authorized in 1950 by amendments to the Social Security Act. In the early 1960s, the federal government began to provide matching grants to states to pay the costs of medical services to aged, blind, or disabled persons who were medically needy but who were not eligible for public assistance. About four-fifths of states participated in these optional programs.

The current Medicaid program--authorized in 1965 under Title XI of the Social Security Act--replaced earlier matching grant programs. By the end of calendar year 1966, Medicaid's first year, 26 states had begun operation of Medicaid programs. Another 11 began their programs in 1967, and all remaining states but Arizona soon followed. 10/

The services covered through Medicaid have changed little over the program's history, but increases in the number of participants and in usage have prompted efforts to reduce program outlays. Both the Omnibus Budget Reconciliation Act of 1981 (OBRA) and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) contained provisions directed toward limiting the increase in Medicaid outlays. The 1981 act provided that the amount that a state was otherwise entitled to receive in Medicaid matching funds would be reduced by 3 percent in fiscal year 1982, 4 percent in 1983, and 4.5 percent in 1984, although these reductions could be avoided if states successfully reduced error and growth rates. States were given additional flexibility in designing and modifying their Medicaid programs to adjust to the reductions, such as the adoption of alternative hospital reimbursement methods and the provision of home- and community-based services for persons who would otherwise require institutional care. TEFRA allowed states to require small copayments by patients in most cases, and expanded the states' authority to impose property liens to pay for nursing home care. It also added home health care services for disabled children as an optional covered service.

In response to severe fiscal pressure, however, some states cut back their Medicaid programs even before implementation of the federal changes enacted in 1981 and 1982. More than 30 states reduced benefits, eligibility,

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10. In 1982, Arizona established a demonstration Medicaid program.

or provider reimbursement in 1981, and approximately the same number made such cutbacks in 1982 after OBRA took effect. Common changes included limiting the number of annual hospital days, limiting payments for emergency room and outpatient care, and dropping eligibility for certain categories of recipients. States also took advantage of the flexibility provided under recent federal acts by, for example, substituting home health care for nursing home care. On the other hand, some states acted in 1982 to reinstate benefits previously cut, to lift access restrictions, or to increase payments to providers. State activity in 1983 has also been mixed, with some states adding or reinstating services and others reducing them.

Recipiency and Benefits. Starting from 11.5 million recipients in 1968, when most state programs had been established, Medicaid participation grew rapidly in the early and mid-1970s as a result of increases in the number of AFDC recipients and in the number of aged, blind, and disabled people qualifying for Medicaid after implementation of national eligibility standards for SSI. The number of recipients has declined from a peak of 22.9 million in 1977 and has fluctuated around 22 million in recent years. In 1982, 44 percent of Medicaid recipients were dependent children, 25 percent were adults in families with dependent children, 15 percent were aged, and 13 percent were disabled.

The federal government requires basic services to be provided under state Medicaid programs, and also pays for selected supplementary services. States must provide inpatient and outpatient hospital care, physicians' services, diagnostic services, nursing home care, family planning consultation, and screening services for children. Required services account for about 55 percent of program outlays. In addition to the required services, each state has chosen to provide some of the optional services, including intermediate (non-hospital) care, prescription drugs, dental services, and prosthetic devices, for example.

Federal outlays for Medicaid increased from $2.7 billion in 1970 to $14 billion in 1980. This large increase was due to a number of factors, notably growing numbers of eligible individuals and increased usage of some medical services. The recent cutbacks in Medicaid, both at states' initiative and in response to federal cutbacks, have reduced the annual rate of increase in Medicaid outlays from an average of over 15 percent annually between 1975 and 1980 to less than 10 percent between 1981 and 1982. Outlays in 1982 were $17.4 billion.

Health Care Grant Programs

In addition to Medicaid, the federal government funds a number of nonentitlement health care programs. These include four block grants--for

preventive health care; substance abuse and mental health; maternal and child health; and primary care--and three narrower-purpose grant programs for family planning services, migrant health services, and black lung clinics (see Table C-6). The Administration has proposed that the latter narrow-purpose programs be folded into the Primary Care Block Grant, which supports community health centers.

The four block grants were created by the Omnibus Budget Reconciliation Act of 1981, which consolidated 21 small categorical health programs. For each of these block grants, funding was set at or below the total that had been appropriated for the individual programs before consolidation. As a result. funding for all the programs consolidated was about 25 percent lower in 1982 than it would have been had current policy in 1981 been continued. Real spending for the three narrower-purpose health grant programs also declined--by more than 30 percent--from 1981 to 1982.

Preventive Health Care. The Congress created this block grant by combining small grant programs for rodent control, fluoridation, hypertension, health education, home health care, and emergency medical services with a previously existing broad-based program for public health services authorized under Section 314(d) of the Public Health Services (PHS) Act. Federal funds are distributed by formula to states and may be used for a wide variety of preventive health services, most of which are also supported by state and local governments. Benefits are community-wide.

Substance Abuse and Mental Health. This block grant combined separate programs for alcohol abuse, drug abuse, and mental health that had been enacted in the 1960s in order to increase the availability of community-based treatment centers. In 1982, states were required to divide spending under the block grant between mental health and substance abuse programs in the same proportions as had existed in the predecessor programs in 1980, although this restriction was to be relaxed and then eliminated in later years (by 1985). Funds are distributed by formula to states. State and local governments provide substantial funding for mental health and substance abuse programs as well, but much of this is for institutional care rather than community-based services.

Maternal and Child Health Care. The 1981 budget reconciliation act combined a number of small grant programs--for services to disabled children, the prevention of lead poisoning, genetic screening, sudden infant death programs, hemophilia treatment, and adolescent pregnancy prevention--with programs for promoting the health of mothers and children in rural or economically depressed regions authorized under Title V of the Social Security Act. Funds are distributed to states by a formula based on the number of low-income children. States are required to provide matching

TABLE C-6. FEDERAL APPROPRIATIONS FOR HEALTH CARE GRANT PROGRAMS, 1982 AND 1983 (In millions of dollars)

Program	1982 Actual	1983 Estimate
Preventive Health Care Block Grant	82	86
Substance Abuse and Mental Health Block Grant	432	469
Maternal and Child Health Block Grant	374	478
Primary Care Block Grant	281	360
Family Planning Services	124	124
Migrant Health Services	38	38
Black Lung Clinics	3	3
Total	1,334	1,558

SOURCE: Congressional Budget Office.

funds--three state dollars for every four federal dollars received. Under the new block grant, states provide services to mothers and children in high risk groups, but they are permitted to establish income-based charges for beneficiaries with incomes above the federal poverty guidelines.

Primary Care. This block grant continued the grants for community health centers established in 1966 under Section 314(e) of the PHS Act. Under this grant, the federal government provides formula grants to states for distribution to local agencies for the development and operation of health centers in communities that are medically underserved. States are required to provide a matching share of funds, which will increase from a fifth in 1983 to a third in 1984.

Family Planning Services. Funding for this grant is authorized under Title X of the PHS Act and is used by state, local, and nonprofit agencies to operate family planning clinics, offering services primarily--but not exclusively--to low-income women and teenagers. In 1981, about 4 million women were served. Funds are distributed among the states by formula based on the number of low-income women and the number of women under 20. Additional federal funding for family planning services is available through the Maternal and Child Health Block Grant, Medicaid, and the Social Services Block Grant. Although state and local governments also fund family planning services from their own sources, it is estimated that 86 percent of all public funding is federal, with 40 percent channeled through Title X.

Migrant Health Services. Grants for migrant health centers are authorized by the PHS Act and are awarded competitively to public and nonprofit agencies in areas with seasonal influxes of migrant workers. Funds are used to provide access to primary health care and environmental health services for about 2.7 million migratory and seasonal farmworkers and their families. In 1981, about half a million persons were served. Although state and local governments provide some funding for these services, federal dollars provide about 95 percent of all public spending for migrant health services.

Black Lung Clinics. The black lung clinics program is authorized under the Black Lung Benefits Act of 1972, and provides support for respiratory and pulmonary health care in areas where there are significant numbers of active and retired coalminers. Services are provided through existing community health centers, other outpatient health care facilities. or free-standing black lung clinics. Funds are distributed among the states by formula, based on the number of active and retired miners. In 1981, the program supported about 70 clinics in 14 states serving between 50,000 and 60,000 persons.